ADMINISTRATION'S FISCAL YEAR 1988 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

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ADMINISTRATION'S FISCAL YEAR 1988 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

THURSDAY, APRIL 23, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 8:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
WEDNESDAY, APRIL 15, 1987

PRESS RELEASE #7
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING
TO CONSIDER THE ADMINISTRATION'S FISCAL YEAR 1988
BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

The Honorable J. J. Pickle, (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to examine the Administration's fiscal year 1988 budget proposals relating to the staffing levels and allocation of resources for the Internal Revenue Service. The Subcommittee also will review the IRS's implementation of the Tax Reform Act of 1986, the examination coverage rates and adequacy of taxpayer services, the status of IRS's computer system and its computer modernization plans, and progress made in the current filing season. Also, the Subcommittee will examine the production and distribution of the new Form W-4A, and the ability of the IRS and the Tax Court to reduce the backlog of pending Tax Court cases. The hearing has been scheduled for Thursday, April 23, 1987, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 8:30 a.m.

Witnesses expected to appear at the hearing include the Internal Revenue Service; the U.S. Tax Court; the U.S. General Accounting Office; former IRS Commissioners; the American Bar Association; the American Institute of Certified Public Accountants; and the National Treasury Employees Union.

In announcing the hearing Chairman Pickle made the following statement: "The Internal Revenue Service faces a tough road ahead. In addition to implementing the most comprehensive rewrite of our tax laws in over half a century, the IRS is required to process returns, issue refunds and handle inquiries from more and more taxpayers. Although this challenge is difficult, we must ensure that the IRS remains an agency which serves the taxpayer and does not simply become a faceless collection agency. I'm hopeful the Subcommittee and the IRS can work together through the challenges of today and tomorrow."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Friday, May 29, 1987, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

SEE ENCLOSED FORMATTING REQUIREMENTS.

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Chairman PICKLE. The Chair will ask the subcommittee to please come to order, and ask our guests to please take their seats.

This morning, the Subcommittee on Oversight is considering the adequacy of the administration's proposed fiscal year 1988 budget for the Internal Revenue Service. This is not an easy task. The Service is this Nation's tax administrator. As such, the IRS has literally hundreds of jobs to do, from rapidly processing the smallest tax refund to thoroughly examining the most complex business return. The Service must efficiently collect the billions of dollars needed to meet our Government's obligations.

In the past, the subcommittee focused its attention on the Service's problems in processing tax returns. I am pleased to see that this year, for the second year in a row, we have had a good filing season.

Finally, the inventories of unpostable returns and taxpayers' correspondence are being brought under control. That ought to make us feel better. But we have also learned, according to an analysis we made, that the Service's accounts receivable inventory is at an all-time high, while audits are at an all-time low.

Voluntary compliance is still declining. The quality and availability of taxpayer assistance is down again. We are still struggling with implementation of tax reform, and nationwide filing of the famous, or the infamous W-4, or the W-4A. Nevertheless, we have made significant progress, I think, in the last 2 years.

Now, the administration is asking for increases in the IRS budget. I would be willing to support increases as long as this subcommittee is assured that the Internal Revenue Service will provide quality taxpayer services. It is not enough that the IRS be this country's tax collectors. We want to see service put back into the Internal Revenue approach.

I know that Commissioner Gibbs feels that way because we can see it and feel it across the land now, and I think that is the emphasis we must continue.

I am also disturbed to find that under the administration's proposed budget there will be fewer IRS employees providing taxpayer service, fewer taxpayers—that is, 4.8 million will receive assistance, and, the quality of answers provided to taxpayers continues to decline.

Well, I hope we can find better ways to address these problems. We are glad that Commissioner Gibbs can be with us here this morning at this bright and early hour, and appreciate his cooperation and the service that he is rendering to us.

I want to ask Commissioner Gibbs if he would proceed with his testimony, and identify the gentlemen at the table with you.

Before you proceed, Mr. Gibbs, we will ask Mr. Dorgan if he has a statement.

Mr. DORGAN. Thank you, Mr. Chairman. I did want to make just a very brief statement at the outset of this hearing, and I must tell the Commissioner, and I already told the chairman, that a very special family commitment today will prevent me from attending the entire hearing, as much as I regret that.

I have been very interested in this general subject of Internal Revenue Service funding, and how we can make the IRS a much more efficient and a much more effective organization, and how we

can make taxpayer service a partner with tax-law enforcement in a way that gives people respect for the tax system.

I, some months ago, formed an ad hoc task force, which includes former IRS Commissioners Jerry Kurtz and Don Alexander, and we have worked in a very serious way for a number of months now, to put together a comprehensive set of recommendations. This set of recommendations will be submitted to the Ways and Means Committee and to the Appropriations Committee.

We will use those recommendations to close the tax gap that exists in this country. Those recommendations are now nearly complete and within days will be released.

I have, along with former Commissioners Kurtz and Alexander, kept in touch with the Ways and Means Committee, and the Appropriations Committee, as well as kept in touch with the Internal Revenue Service on it. I did want to make note of that effort and indicate that it is, I think, one of the more sober attempts in recent years to put together a comprehensive set of recommendations to analyze how we can do two things.

One, as the chairman so eloquently stated, put the "service" back in the Internal Revenue Service, and two, while we do that, provide a substantial increase in tax-law enforcement, so that we can raise additional moneys without a general tax increase.

If we close the tax gap by one-third, we will raise over $30 billion a year in additional revenue from freeloaders and escape artists who are not now paying taxes but should be. We do this without having to increase taxes for the American people, 99 percent of whom are honest and who meet their obligations on time.

Mr. Chairman, I did want to make note of that effort, and indicate that the final results of that task force will be released within days. I want to thank you for your cooperation and thank the subcommittee, and the Commissioner as well.

[The following was subsequently received:]

The Honorable Byron L. Dorgan

Statement before Subcommittee on Oversight on April 23, 1987:

Mr. Chairman, I am glad that we have the opportunity today to look more closely at the President's FY88 budget for the Internal Revenue Service. While I am pleased to see that the Administration is increasing the budget with regard to the enforcement side of the IRS, I am disappointed that the President fails to recognize just how important the taxpayer service is. I do not understand why this Administration does not understand that to ensure the stability of the voluntary tax system, we need to make taxpayer service a partner with enforcement. Striking an appropriate balance of these two areas is essential to a healthy tax system.

The President's budget misses the point that enhanced taxpayer service and enforcement translate into better tax compliance and revenues for the Treasury. The cuts the Administration is proposing for the taxpayer service make no sense to me whatsoever. For example, the President is proposing 191 fewer positions than in FY 1987. The IRS had requested 1,698 more taxpayer service positions than OMB included in the final budget. The President's budget also estimates assisting 4.8 million fewer taxpayers than assisted in FY87. By reducing taxpayer assistance, the IRS is contributing to the noncompliance problem.

The President's budget does in general recognize the importance of the enforcement side of the IRS. But, here too, the President does not go far enough in some areas. For example, the FY88 budget for audit coverage includes a stafing increase of 2,837 positions that will result in an audit rate of 1.61% in FY88. This audit rate is lower than in 1980-1982! Under the President's budget the examination rate will be up to 2.06% by FY92, but this is not good enough. I believe that it should approach 2.5% by then. The bottom line is that improving enforcement efforts will mean greater taxpayer compliance and large revenues for the Treasury.

I believe that this balance in the IRS is essential to help close the tax gap that now exists. The tax gap is widening at an alarming rate and we need to confront this problem head on. Today compliance stands at just 80% reflecting a $103 billion tax gap. This low compliance level has a detrimental impact on our economy and on the stability of our voluntary compliance tax system. More disturbing is the fact that by 1992 the IRS estimates that the tax gap will be more than $200 billion. In an era of budget cutting-mania it is incomprehensible that we ignore this issue.

I have been working for several months with a task force to find ways of improving compliance and enforcement and thus bring billions of dollars into the Treasury. The proposal will be released in a few days. The approach we want to take is two-fold, that is, offer taxpayers more efficient and higher quality service from the IRS, and also improve the enforcement capability of IRS to ensure that those who fail to comply are found and prosecuted.

With regard to taxpayer service, I believe that enhanced, quality service to the taxpayer will increase compliance. The goal is to put the "service" back in the Internal Revenue Service. The flip side of this approach is tougher enforcement. Once you're providing better taxpayer service, you should expect better compliance. If people know there is good chance of getting caught and being prosecuted, they'll be more apt to comply.

More funding is necessary to support these efforts. More staff and funding for taxpayer service and enforcement will help reduce the budget deficit. If you can get a yield of perhaps 10-1 or 17-1 for every dollar you spend to improve taxpayer service and enforcement, then why not do it?

I believe that these efforts will result in greater taxpayer compliance; a reduction of the tax gap producing billions of dollars; a painless reduction in our bulging deficit; and less pressure to cut dollars out of necessary domestic programs. In my opinion, the President's budget needs to be revised so that it produces a greater balance between service and enforcement, and so that it will close the tax gap more quickly and efficiently.

The Report of

The Dorgan Task Force

on

Narrowing the $100 Billion Tax Gap

By Congressman Byron L. Dorgan
and
The Dorgan Task Force
Cochaired by:
Donald C. Alexander
Jerome Kurtz

May 4, 1987

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The Report of The DORGAN Task Force

I. The Task Force.

The Internal Revenue Service (IRS) has estimated that the gap between income taxes owed and income taxes actually paid exceeded $100 billion in 1986 and is growing. Recognizing that the "tax gap" has contributed in a major way to the budget deficit, Congressman Byron L. Dorgan (D-ND), himself a former state tax commissioner, formed a bipartisan Task Force of tax professionals with a variety of public and private sector experience to study the $100 billion tax gap and to recommend measures by which the tax gap could be narrowed.

Two former IRS Commissioners, Donald C. Alexander (1973 to 1977) and Jerome Kurtz (1977 to 1980) agreed to co-chair the Task Force. The other members of the Task Force are John B. Jones, Jr., Chair of the American Bar Association's Tax Section; Herbert E. Lerner, Chairman of the Tax Division of the American Institute of Certified Public Accountants; Ira A. Jackson and Thomas D. Herman, respectively Commissioner and First Deputy Commissioner of Revenue for the State of Massachusetts; Bernard M. (Bob) Shapiro, former Chief of Staff of the Congressional Joint Committee on Taxation; William W. Chip of Cadwalader, Wickersham & Taft; and Andrew W. Kentz, Legislative Counsel to Congressman Dorgan. Prior to his appointment to the office of Deputy Assistant Treasury Secretary (Tax Analysis),

Eugene Steuerle, then of the American Enterprise Institute, was also a member of the Task Force.

The observations and recommendations contained in this report are the joint work product of the Task Force members acting as individuals. They are not to be taken as representing the positions of their respective organizations

II. The Tax Gap.

The "tax gap" is the difference between the amount of taxes voluntarily paid by individuals and corporations and the amount of taxes that would be collected if the rate of individual and corporate compliance with the tax laws were 100 percent. The IRS has estimated that taxpayers owed the government approximately $556 billion of income taxes in 1986 but would voluntarily pay only about $453 billion of those taxes. In other words, only 82 percent of taxes owed would be paid voluntarily, leaving a "tax gap" of over $100 billion. The IRS has projected that by 1992 the tax gap will exceed $200 billion.

These estimates relate only to income taxes on income from legal sources, i.e., they do not take into account income taxes on illegal income or any gap in the collection of estate, gift, employment, or excise taxes.

III. Executive Summary.

The Task Force believes that a "tax gap" of $100 billion or anything approaching it is morally and fiscally

unacceptable. The tax gap is morally unacceptable because millions of honest taxpayers are carrying the burden of taxes unpaid by those who shirk their obligations. The tax gap is fiscally unacceptable because it has contributed in a major way to the federal budget deficit.

While the tax gap cannot be closed completely, the Task Force concluded that a substantial amount of the tax gap could be collected through measures that were economically efficient and socially acceptable. In order to narrow the tax gap, the Task Force has proposed new and higher standards for the IRS in the areas of assisting taxpayers, examining returns, and collecting delinquent taxes. To ensure that these standards can be attained in a reasonable space of time, the Task Force has proposed a five-year plan of substantial changes in IRS operations and growth in IRS resources.

This five-year plan is designed to raise the compliance rate by a full percentage point in each year from 1988 through 1992. The Task Force has estimated that each percentage point increase in the compliance rate will narrow the tax gap by approximately $7 billion per year. If the five-year plan recommended by the Task Force is adopted, by 1992 the tax gap will have been narrowed by $35 billion. Over the duration of the five-year plan, a cumulative $105 billion of additional revenue will have been collected. An additional $35 billion or more would be collected each year thereafter.

An increase in IRS resources of the magnitude recommended by the Task Force will not increase the federal budget deficit, but will instead reduce it, because many dollars of additional tax will be collected for every additional budget dollar expended.

IV. Observations About the Tax Gap.

The following are general observations of the Task Force on the subject of closing the tax gap.

A. Can the Tax Gap be Eliminated?

The Task Force concluded that complete elimination of the "tax gap" would be an unrealistic objective. Some of the tax is owed by taxpayers who are financially unable to pay. Some of the tax gap represents small sums owed by large numbers of taxpayers, which could be collected only at a cost that would approach or exceed the amount of taxes that would be collected. Other taxes could be collected only through an invasion of privacy and a severity of enforcement not tolerable in this country.

Although the Task Force recognized that the tax gap could not be closed entirely, it was convinced that a substantial portion of the tax gap is due to individual and corporate non-filers and evaders from whom unpaid taxes can and should be collected. The Task Force believes that even full implementation of all its recommendations would not exhaust the potential for

collecting unpaid taxes in an economically efficient and socially acceptable manner.

B. The Need for Balance.

The Task Force believes that a balanced approach to tax administration is as important as increasing the resources devoted to tax collection. Specifically, the Task Force feels very strongly that providing services to the great majority of taxpayers who wish to comply with the law is no less important than enforcing the law against those who attempt to evade their responsibilities.

C. Certain Problems are Endemic.

The Task Force was regularly reminded by its members with public sector experience that many of the problems faced by the IRS in its effort to close the tax gap are not uniquely problems of the IRS. Rigidities in the Civil Service system that inhibit recruitment and retention of qualified personnel for certain positions and geographical regions, as well as shortcomings in the budget process that frustrate long-term planning, are examples of factors that hinder many federal administrative agencies, not just the IRS. Consequently, narrowing the tax gap may require changes with much broader implications than tax collection.

D. Revenue and the IRS Budget.

The Task Force felt that, historically, both Republican and Democratic administrations have failed to account adequately for the revenue impact of the IRS budget. Although the IRS has a

unique revenue-generating function, it has not been immune to across-the-board budget cuts. Proposed IRS budgets have often been influenced more by overall federal employment targets than by their effect on revenue. In recent years the committees of Congress have been increasingly sensitive to the linkage between the amount spent on tax collection and the amount of taxes collected. However, the Congressional budget process, which separates responsibility for funding the IRS from responsibility for raising revenue, hinders full recognition of that linkage.

E. Measuring Revenue Impact.

Even when the revenue impact of the IRS budget is taken into account by policymakers, the impact is likely to be understated because much of the revenue impact is not measurable. For example, raising the percentage of returns that are examined directly increases taxes collected by a predictable amount. However, increased audit activity also has an impact on voluntary compliance by millions of taxpayers who are not actually audited. Similar effects will result from providing taxpayers with services that facilitate and encourage compliance. Although these indirect effects may be more important over the long run in narrowing the tax gap than the direct effect of increased enforcement, the indirect effects are not readily measurable. For this reason, decisions to fund the IRS that are based entirely on measurable revenue effects will tend to result in substantial underfunding and misdirection.

F. The Experience of the States.

One of the advantages of the federal system is that all of the governments in the system can learn from the experience of the others. The State of Massachusetts, whose Governor is represented on the Task Force by his Commissioner and First Deputy Commissioner of Revenue, embarked several years ago on an innovative campaign to improve voluntary compliance with the tax system. The Massachusetts campaign combined a taxpayer outreach program, utilizing "taxmobiles" and other imaginative techniques to bring services to the taxpayer, with more thorough enforcement against tax evaders. Similarly, the State of North Dakota has had great success with its "fair share" program.

In shaping its own recommendations, the Task Force has followed the Massachusetts and North Dakota approach of coupling a new thoroughness in enforcement with greatly improved taxpayer services.

V. Specific Recommendations.

A. Improve Taxpayer Services.

1. Bring Services to Taxpayers.

In spite of the 1986 Tax Reform Act, the tax law remains very complicated. In 1988 taxpayers will require increased levels of taxpayer assistance in order to cope with the many changes made by the Act. Taxpayers have a right to assistance from the government in understanding and fulfilling their obligations. The Task Force also believes that taxpayers

who understand their obligations and receive cooperation and assistance from the IRS in fulfilling those obligations are more likely to pay the full amount of taxes owed.

The Task Force commends the IRS on the programs already in place to serve the American taxpayer. However, the Task Force believes that these programs need to be expanded to ensure that all taxpayers will benefit. Moreover, the IRS must not wait passively for taxpayers to solicit help. Rather, it should reach out and make its services available at times and places convenient to the taxpayer. The Task Force therefore recommends that the IRS (1) institute a pilot program called "IRS Assistance Across America" utilizing "taxmobiles", "tax fairs", and other innovative approaches to bringing taxpayer services to taxpayers in rural areas and to other taxpayers not well served by present programs, and (2) expand by 365 the number of temporary walk-in offices open during the tax filing season. To make these improvements possible, the Task Force recommends that Congress increase authorized positions for taxpayer outreach programs by approximately 500 in FY88 and by an additional 125 in each fiscal year from FY89 through FY92.

2. Taxpayer Assistance.

The Task Force believes that taxpayers need and should receive additional help in preparing their tax returns. The Task Force therefore recommends: (1) the expansion and improvement of tax return assistance programs, and (2) the expansion of current programs for taxpayer education. In order to make these

improvements, the Task Force recommends that Congress increase authorized positions for taxpayer assistance and education by approximately 1,600 in FY88 and by an additional 400 in each fiscal year from FY89 through FY92.

3. Upgrade Telephone Service.

One of the most important forms of taxpayer service is telephone assistance. Private industry measures the adequacy of telephone assistance through a formula that approximately measures the percentage of callers who have their calls answered. Some industries achieve a 95 percent service rate for their customers. The IRS service rate is currently 75 percent. The IRS considers an 85 percent service rate to be optimal. The Task Force recommends that the IRS achieve an 80 percent service rate for taxpayer telephone assistance in FY88, an 85 percent rate in FY89, and a 90 percent rate by FY92. Further, the Task Force recommends that assistance hours on evenings and weekends be expanded. To attain these goals, the Task Force recommends that Congress increase authorized positions for taxpayer telephone assistance by approximately 1,000 in FY88 and by an additional 250 in each fiscal year from FY89 through FY92.

4. Improve Telephone Accuracy.

The Task Force is very concerned about the unacceptably low accuracy levels of IRS telephone assistance. Taxpayers will lose confidence in the tax system if they cannot get an accurate response to a question about the tax law from the very agency responsible for enforcing that law. The Task Force therefore

recommends that the accuracy of telephone responses be improved through enhanced training of telephone assistors and by achieving a one-to-one ratio of assistor to computer.

5. Prompt Mail Response.

The taxpayer who takes the time to write a letter to the IRS should be able to expect a prompt response. The Task Force therefore recommends that the IRS strive to answer all mail within 14 days of receipt. In order to accomplish this, the Task Force recommends that Congress authorize approximately 200 additional positions in FY88 for mail response.

6. Report to Congress.

The Task Force believes that taxpayer services must be accorded the same level of attention as enforcement. The Task Force recommends that the IRS report annually to the Ways & Means and Finance Committees on taxpayer services, including types of questions and inquiries received, the number of persons served, telephone assistance service rates, the accuracy of IRS advice to taxpayers, etc.

B. Expand Enforcement.

1. Raise the Examination Rate.

The percentage of returns that are examined has declined from 2.5 percent in 1976 to 1.14 percent in 1986. Some of the decline represents a focusing of resources on tax shelters, information return matching, and other activities that also serve to narrow the tax gap. Nevertheless, the Task Force members were concerned that an increasing number of taxpayers

feel that the probability of being examined is so low as to be disregarded. The Administration's FY88 budget proposes a substantial increase in appropriations and positions for the examination function. The Task Force recommends that the examination rate be increased to 2.5 percent by 1992. To make this possible, the Task Force recommends that Congress authorize the additional positions requested by the Administration for the examination function in FY88, and increase authorized positions for examination by approximately 3,000 in each fiscal year from FY89 through FY92.

2. Expedite Appeals and Litigation.

An increased examination rate will bring about a corresponding increase in appeals within the IRS and cases before the courts. The expeditious handling of appeals and litigation is a taxpayer's right as well as a necessity if deficiencies uncovered upon examination are to be collected promptly. The Task Force therefore recommends that Congress increase authorized positions for appeals and litigation by approximately 600 in each fiscal year from FY89 through FY92.

3. Increase Collections.

The Task Force concluded that the inability of the IRS to enforce promptly the payment of accounts receivable reduces the credibility of the rest of the tax system. There is currently approximately $13 billion in the delinquent accounts segment of accounts receivable. The Task Force recommends that the IRS collect at least 50 percent of delinquent accounts by

FY92. To accomplish this goal, the Task Force recommends that Congress increase authorized positions for the collection function by approximately 1,200 positions in FY88 and by an additional 1,200 in each fiscal year from FY89 through FY92. The Task Force also felt that the collections function of the Internal Revenue Service has lagged behind the private sector in terms of debt collection practice and technology. The Task Force therefore also recommends that the General Accounting Office report to Congress comparing the effectiveness of Internal Revenue Service debt collection practices and technology with the best private sector practice and technology.

4. Hire More Special Agents to Combat Tax Evasion.

Special agents are specially trained revenue agents who deal with cases involving evidence of fraud or other criminal misbehavior. The Task Force believes that current efforts to uncover and prosecute tax crimes are inadequate. The Administration's FY88 budget proposes no significant increase in the number of special agents. The Task Force recommends that funds be appropriated to increase the number of special agents by 250 in FY88 and by an additional 250 in each fiscal year from FY89 through FY92.

5. Study Prosecutions.

The decision whether to prosecute a tax crime and the actual prosecution of the crime is handled by the Justice Department. The Task Force was concerned that a large number of

serious tax crimes were not being prosecuted for a variety of reasons, including insufficient resources and inadequate coordination between the IRS and the Justice Department. The Task Force recommends that the General Accounting Office report to Congress on the efficacy of the current arrangements between the Internal Revenue Service and the Justice Department for prosecution of tax criminals.

6. Match Proprietorship Returns.

Failure to report income is by far the most important form of tax evasion. It is also the most difficult to uncover by examination. The IRS program for matching income information returns to individual tax returns has been very successful in identifying certain types of unreported income of individual taxpayers. The Task Force recognizes that the use of non-calendar taxable years and the accrual method of accounting by corporate taxpayers may preclude, for the time being, a cost-effective matching program for many business taxpayers. However, a limited matching program for sole proprietorships is not precluded by these factors. The Task Force therefore recommends that the IRS implement an information return matching program for proprietorships and that Congress authorize the additional positions requested by the Administration for this program.

7. Collect More Taxes on Foreign Income.

Evidence has accumulated in recent years that income earned outside the United States often escapes taxation. The IRS plans to conduct a study of this subject in FY89. The Task Force

recommends that the IRS accelerate the completion date of its foreign income study and expand its current programs to locate overseas non-filers, investigate "tax havens", and deal with money-laundering schemes. To facilitate expansion of existing programs (and such new programs as the IRS study concludes are needed), the Task Force recommends that Congress increase authorized positions for investigating overseas tax havens by approximately 600 positions in FY88 and increase authorized positions for other overseas enforcement programs by approximately 250 in each fiscal year from FY88 through FY92.

8. Raise Penalty for Wealthy Non-Filers.

The Task Force believes that the failure to file a return, particularly in the case of a wealthy taxpayer, is a serious crime that results in a substantial loss of taxes collected and the undermining of compliance by other taxpayers who perceive that the rich can avoid taxes. The Task Force therefore recommends that failure to file a return be increased from a misdemeanor to a felony when the taxes owed equal or exceed $10,000.

C. Administration and Budgeting.

1. Authorize Two-year IRS Budget.

Implementation of the Task Force recommendations involves a substantial and steady increase in IRS resources over an extended time frame. In order for these additional resources to be absorbed efficiently, the Commissioner must be able to plan ahead. The current budget process interferes with long-term

planning by the IRS and other federal agencies. To enable longer-term planning by the defense department, the Administration's FY88 budget proposes shifting to a two-year budget for defense. The Task Force recommends that, beginning with FY88-89, the Congress approve a two-year budget for the IRS.

2. Increase Flexibility in Allocation.

Under current law the IRS Commissioner has authority to shift only 1 percent of his budget between accounts. This reduces his ability to apply resources where they will be most effective in narrowing the tax gap. The Task Force therefore recommends that the Commissioner be authorized to shift up to 5 percent of his budget between accounts.

3. Fund Unrelated Functions Separately.

Over the years, the Internal Revenue Service has been tasked with a number of responsibilities not directly related to the tax system. The Task Force was concerned that assignment of unrelated functions to the IRS diverts resources that have been appropriated for tax collection, thereby exacerbating the tax gap. The Task Force recommends that IRS not be assigned functions unrelated to tax collection and that existing unrelated assignments be eliminated where feasible. In addition, the cost of unrelated functions assigned to the Internal Revenue Service should be identified as a separate budget item, with appropriations to be the responsibility of the committee or subcommittee primarily responsible for that function.

4. Tax "Loophole" Task Force.

Congress occasionally passes tax legislation without full awareness of the potential for tax avoidance in some of its provisions. The Task Force recommends that the IRS establish a task force that will report to the Ways & Means and Finance Committees on a regular basis concerning those tax provisions that are being used by taxpayers to reduce taxes in a manner or to a degree that may not have been anticipated by Congress.

Chairman PICKLE. Well, Mr. Dorgan, I appreciate your interest in this subject, particularly, and we will be looking for that report. I understand that it will be out in a few days, and I am sorry that you cannot be with us for the whole hearing today, but I understand your commitment.

[Mr. Schulze submitted the following opening statement:]

OPENING STATEMENT OF HON. DICK SCHULZE

Mr. Chairman, I am pleased to join you in today's hearing on the fiscal year 1988 budget of the Internal Revenue Service. I also welcome the opportunity to follow up on several of the administrative issues which we considered at our February 6 hearing on IRS operations.

Even before the fiscal year 1988 budget exercise begins, the IRS will have its fiscal year 1987 budget augmented by over $200 million in the Supplemental Appropriation bill. Eighty million dollars in the Supplemental Appropriation is earmarked for implementing tax reform. I want to get a better understanding of how the IRS will use the $80 million.

We should consider whether the $80 million is enough to implement tax reform. If more resources are needed for tax reform then perhaps the IRS could re-program some of its current funds instead of solely looking to Congress for more money.

The fiscal year 1988 budget of the IRS is slightly over $5 billion and covers about 110,000 personnel. This represents about a $600 million increase over the FY87 level and about 10,000 more personnel. I am interested in learning how these additional resources will be used.

My preliminary review of the IRS FY88 budget suggests that most of these additional resources will go towards improved enforcement activities. This emphasis is understandable since improved enforcement leads to improved revenue collections. However I will be looking to see if the emphasis on enforcement has been matched by adequate resources for taxpayer service, including the implementation of tax reform.

The increase in the backlog of cases at the U.S. Tax Court has risen significantly in recent years. Some persons have said that the phase-out of the deductibility of non-mortgage interest will discourage litigants from pursuing lengthy Tax Court cases. The implication is that this feature of tax reform may reduce the backlog. I am anxious to learn whether our witnesses share this assessment, and whether this change alone will be enough to reduce the case load to manageable levels.

Next, I believe the Subcommittee will benefit from a follow up on issues which we considered at our February 6 hearing. In particular, I am eager to learn how the W-4 withholding certificate effort is going.

The simplified W-4A certificate is a welcome improvement over the original W-4 certificate. I would like to learn the timetable for distributing the W-4A form. Finally I look forward to an update concerning how many taxpayers have filed either the original W-4 or the simplified W-4A form.

Mr. Chairman, the IRS budget and the administrative issues under review today may not seem significant to the so-called tax-policy experts. But these issues are very important to the 100 million taxpayers which make up our constituency. I believe that it is only fair that we pay the same attention to the practical concerns of the taxpayers as we pay to the theoretical concerns of the tax policy "thinkers."

Mr. Chairman, I look forward to receiving the testimony of today's witnesses.

Chairman PICKLE. Now Commissioner Gibbs, we are glad to have you here. We have a lot of questions to ask you. We will not ask you to present your statement. We recognize again, I do, at least, that you are trying to put service back into the IRS, and, Austin, Texas alone, at the IRS center there, last month they organized a car wash.

They advertised on the radio and in newspapers, if you file early we will give you a free car wash, and people did not believe that, but they came out, and we helped them wash their cars as they came through to file their returns.

The point is that the idea, and the desire to do that came from the IRS employees. That is commendable. And even last week

when I was there, on Saturday I went down to the office to work, and there was a sign saying that if you want to file your income tax return, you can get into the building by a certain door, and come on in. This was Saturday morning.

That is good to see. I think that is some indication of what is happening across the land.

But we have got a lot of problems now, particularly on the budget, so we ought to ask you to proceed, and then we will ask questions afterwards.

So, we are glad you are here, Commissioner.

STATEMENT OF HON. LAWRENCE B. GIBBS, COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY THOMAS COLEMAN, REGIONAL COMMISSIONER FOR THE WESTERN REGION; AND STEVEN TAYLOR, DIRECTOR, IRS FINANCE DIVISION

Mr. GIBBS. Thank you, Mr. Chairman. It is good to be here this morning, and we really appreciated the cars you helped us wash in Austin, Mr. Chairman.

I would like to begin by introducing the two gentlemen here with me. On my left, and your right, is the Regional Commissioner for the IRS Western Region, and presently the Acting Associate Commissioner for Operations, Tom Coleman.

And on my right, your left, is someone I think you all know, and that is Steve Taylor, who is the Director of our Finance Division, and is largely responsible for the details and implementation of our budget.

I would like to begin this morning, Mr. Chairman, by giving you a quick summary of the most recent numbers with respect to our filing season this year.

We are pleased and proud, if not satisfied—I do not know that we will be ever totally satisfied—but we are very proud and pleased of the filing season this year. As of April 17, we had received about 89.2 million individual income tax returns. We had processed about 58.2 million, and that is up over 2 percent from last year this time.

We had certified about 46.3 million refunds, which is up slightly from last year, and we had refunded about $38.2 billion which is up 1.4 percent from last year. Our average refund is running slightly ahead of last year, with the average refund of about $825 so far this year.

We also responded to over 34 million questions with respect to the technical tax law, refund, account, and forms inquiries. In the process of doing all of this, we have also managed to reduce our adjustments inventory by about 50 percent from this time last year. The average age is about 21.7 months, and that is down substantially. There are seven of ten centers that are actually below this average age, which we consider excellent.

Our unpostable inventory is down about 60 percent, and 6 of the 10 centers are well below what we would consider the normal range with respect to unpostables. In short, overall, the tax season has gone very smoothly.

I would now like to update you on our computer issues. I know you are interested.

With respect to our front-end processors, the ones that we have in our centers at the present time, and the ones that you have been concerned about, they are operating quite well. We still have the two that we are holding in reserve, if we should need them. We have not had any major problems with the front-end processors this year.

The Sysorex matter is proceeding on schedule. We have done several things there, that I am glad to report. One is that recently we had a test with respect to the system, and the system is performing at this time in accordance with the requirements that we had specified in the contracts. The system was supposed to handle 60 transactions per second; it is actually handling 70 transactions per second. We anticipate that will go up.

Chairman PICKLE. Is that your test?

Mr. GIBBS. That is correct. It is a test that we have done recently.

Chairman PICKLE. With Sysorex?

Mr. GIBBS. That is correct.

Chairman PICKLE. Well, now, does that mean that you are satisfied it has passed the test, or that you have further tests before——

Mr. GIBBS. I am saying at this point we are very satisfied. There are additional tests, Mr. Chairman, that that system must meet, but what I am saying is, for the first time we are beginning to see the system perform in the way that we had expected, and the way we had contracted for it to perform. We actually now have a test where, significantly, the transactions are going through the system.

Chairman PICKLE. All right.

Mr. GIBBS. We will have another test in June that will be a major test, and, from the standpoint of the software programming, we are staying up with it literally on a day-by-day basis. We expect that as we get to May and into June, that we will be updating the Subcommittee with respect to the progress that we are making there.

Chairman PICKLE. I am not going to keep interrupting, but in June, when you have this second test, is that supposed to be the final test?

Mr. GIBBS. Yes, sir.

Chairman PICKLE. And if it then passes, will you make an official report to us, that it complies with your requirements and that you are satisfied?

Mr. GIBBS. Absolutely. One way or the other, we will be back and report to you in June, because if the June test goes, then that is when we begin to move forward in actually taking them to the centers.

[The following was subsequently received:]

CLARIFICATION OF REMARKS

Although a final test will be run in June 1987, it should be noted that this test, the System Operational Capability Test (SOCT), is only one of several tests which must be successfully passed by the vendor. The SOCT will be run at the National Computer Center (NCC) using test data created by the Service. The SOCT begins on June 15 and must be successfully completed within two weeks, at which point the NCC Acceptance Test begins and runs until the vendor has met all contractual requirements. We anticipate that this should be completed by August 15, 1987. (Several SOCT-like tests have already been successfully run, the latest of which was held on May 6, 1987, and attended by personnel from the General Accounting Office.)

Production testing will follow installation of the Fresno Service Center's CRS starting within the period June 15 through September 27, 1987. This involves the sequential transferring of terminals from the existing DCPS 90/40 front-end processor to the CRS and operating the new equipment using live data in an actual production environment.

On September 28, 1987, the actual FSC Acceptance Test begins and runs until the vendor has met all contractual requirements. This should be completed by November 9, 1987. Lease costs are not applicable until the Acceptance Test is completed. A similar Acceptance Test will be performed at each Service Center.

Chairman PICKLE. All right.

Mr. GIBBS. At the same time we are doing this, I would also like to point out that another part of this is that we are already moving forward in Fresno, Calif., and in the districts our center there supports to replace terminals out there that will eventually tie into this new system. That also is going extremely well.

So we now have terminals on line of the new type, and they are functioning and actually tied into the computers we have at the present time. So that, too, is going well.

Chairman PICKLE. I will make one more interruption and then I will stop. In connection with these tests, and the one coming up, does this mean, now, that the subcontractors are working in accord, that they are satisfied?

Is there any discord between the various contractors involved, or don't you know?

Mr. GIBBS. Mr. Chairman, we are working with the contractor. As best we can tell, things seem to be going smoothly. If there is discord among the subcontractors, I am not aware of it at the present time, from the standpoint of the thing moving forward.

Chairman PICKLE. Well, there has been considerable disagreement about who has been "at fault," or in error, or who is performing adequately.

And I am assuming now, if you are passing the tests, that everybody's cogs are working within the other's cogs, and it is all satisfactory, in general.

Mr. GIBBS. Mr. Chairman——

Chairman PICKLE. So give us your report on your next test. We want to know that.

Mr. GIBBS. Absolutely. And we have even made it clear that we are looking to the contractor on this, and really are not interested in any intramurals between the contractor and the subcontractor so long as they perform in accordance with the contract.

Chairman PICKLE. All right.

Mr. GIBBS. In discussing our budget for fiscal year 1988, I would like to give just a very, very brief overview, and really, it is a summary of what you, Mr. Chairman, and you, Mr. Dorgan, have said thus far this morning.

I think it is significant that the Internal Revenue Service is being recognized as a revenue center within the Government—a center where, from a budget standpoint, we can make money by spending money. But more importantly—and I think this is the point, Mr. Dorgan, that you were making—it is being recognized that a major element of fairness, which is so important to our tax administration system, is for people to believe that if they pay their fair share, and others do not, then Congress is going to fund

the agency to permit us to detect those who are not paying their fair share, and cause them to do so.

The revenue side of our budget is obviously very strong from the standpoint of the overall thrust of the fiscal year 1988 budget for the Internal Revenue Service.

At the same time, I am saying, have said, and will continue to say, that there is another essential element of fairness that is just as important as the compliance side. People who are trying to comply, and having problems, must believe that the Internal Revenue Service will have the resources and the attitude to help them with professional, competent, accurate, and prompt assistance. This is the service side of the budget which I will be glad to discuss with you further this morning.

As we move to this balanced approach of compliance and service, I am suggesting that the Internal Revenue Service bring an attitude of seeing taxpayers as our customers, across the agency. We must not think only in terms of taxpayer service or problem resolution, which are specific functions within the organization. Rather, across the organization we must adopt the attitudes and the procedures that will begin to recognize taxpayers as customers, in terms of being courteous, in terms of being professional, and in terms of being prompt and accurate in what we do and how we do it.

I think it is important from the standpoint of not only the image of the Internal Revenue Service, but also people's attitudes about the fairness of our tax administration system. I think it underlines the importance of the law that was passed last fall, which is intended to address the perception of unfairness in the country in terms of similarly situated taxpayers in the past not having been taxed in the same way.

As we approach that element of fairness in implementing this new law, I think it is particularly important to emphasize the fairness and the compliance on the customer service side as well, and that is what we are about at the Internal Revenue Service today.

Another thing that you will see in the budget, that has been there for several years, is the increasing use of technology to support these two aspects of what we do—the compliance side and the service side. That is something else that we have already discussed this morning and we are going to be discussing in more detail with you.

Our fiscal year 1988 budget, as proposed, would give us over 110,000 average positions, and would be approximately $5.1 billion, which is an increase of about 9,500 average positions and about $624 million over the fiscal year 1987 budget.

It will permit us to collect, with our tax system in this country, a total of some $840 billion during 1988. That fact alone makes us the envy of the free world, to have a tax administration system depending on voluntary compliance to collect those kinds of dollars.

Chairman PICKLE. What is the amount of the change?

Mr. GIBBS. It is up by about $40 billion from 1987, Mr. Pickle.

The budget will permit us to process about 186 million returns. It will permit us to assist over 60 million taxpayers. Overall, particularly in Gramm-Rudman-Hollings times, I am satisfied with our overall budget.

The major components of our budget include a very strong revenue initiative to permit us to collect additional revenues. Additional funds are requested to improve tax administration by expanding electronic filing and maintaining taxpayer service. Additional funds are also requested to implement our information systems and computer initiatives, including initiatives for automation of our taxpayer service area. Initiatives on the compliance side include our automated examination system and our automated collection system as it moves into the integrated collection system, which will complete the computerization of our collection activities.

So overall, we have the three themes of additional funds for compliance, additional funds for customer service, and additional funds for technology to enhance our capability on the compliance side and on the customer service side.

A key element of our budget this year is the fact that we are seeking a 5 percent transfer authority among our four operating appropriations. This is extremely important because with tax reform, we cannot entirely predict what demands are going to be placed upon us particularly in the taxpayer service area.

With this additional flexibility, we will have the opportunity to address problems, if any arise, in an appropriate way, and for that reason I would particularly urge the committee to review, and if you feel it is appropriate, support our 5 percent transfer request.

With respect to implementation of the Tax Reform Act itself, we are in the midst of a major effort that will continue the rest of this year, on into the filing season next year and over the next several years. We have already issued approximately 20 regulations, 30 notices, 22 announcements, 35 news releases, and a handful of revenue procedures. We have plans for media spots on 800 television stations and 7,000 radio stations about this new law, and our activities with respect to it. We also are planning TV shows for later this fall. We have already had some earlier this spring. Again, they are designed to permit taxpayers to call in and ask us questions about the new law.

We have two publications with respect to the new law that will be out later this spring. In May, June and July, we are actually going to put out the draft 1987 forms for public comment, to let people see what they look like, and to let them compare them to the 1986 forms. We welcome their suggestions, constructive comments and criticisms with respect to those forms, so that we can consider the suggestions as we finalize the forms.

Our extensive training efforts on tax reform are already underway throughout the organization, as detailed in my opening statement.

In short, Mr. Chairman, with respect to tax reform, we recognize the obligation that the agency has to respond to the challenge of implementing this law in such a way that it can be perceived as fair, and that it will work from the standpoint of the way that it is going to affect the American taxpayers this year, and particularly in the filing season next year.

Mr. Chairman, what I would now like to do, to conclude my testimony, is to use the charts which are on your right, which summarize the testimony that I have just given. And I would like to ask you before I begin, whether you four gentlemen are able to see the

charts. If you are not, then we will move them closer to you. They are also attached to your testimony.

Chairman PICKLE. I would move them about 20 feet closer.

Mr. GIBBS. Fine.

Chairman PICKLE. That helps, and I think we have the printed figures here.

Mr. GIBBS. I would like to take you through the charts because I think they really do summarize very well our budget this year.

The first chart deals with our revenue initiative, and it shows it in three categories. The first is what our investment is going to be, or what we are asking in the way of budget funds. The second column is what the revenue return will be, and the third column is the return on investment.

Our budget request in the examination area will be about $226 million, and it will produce a return of about $1.1 billion, or about a 4.8 to 1 return on investment.

In the collection area, the investment will be about $122 million, producing a return of over $1.1 billion, or a 9.2 to 1 return on investment. And in our document-matching area, we are talking about an investment of $35 million that we estimate will produce revenue of $224 million, or about a 6.3 to 1 return.

In short, with about a $384 million investment, based on modeling and based on our experience, we project a return of $2.4 billion, or about 6.4 to 1.

Another way of looking at this, that is shown by our second chart——

Mr. THOMAS. Before you flip that, do you have returns on investments, and collecting unpaid taxes; 122 with a $1.1 billion return, so obviously we have diminishing returns as the numbers go up.

But how do you settle on 122? Why isn't it 200 with a return of $2 billion, or, would it drop dramatically? How do you come up with the ratio, in terms of what you have invested, as to why that is the appropriate amount given a 9.2 to 1 return.

Do you understand my question?

Mr. GIBBS. No, sir. I do not.

Mr. THOMAS. If spending 122 gets you a 9.2 return of 1.1 billion, what happens if you spend 200? Do you have a diminishing return on investment to the point that it is not worth it? Or did you simply lose in a budget battle and you did not get more money there?

You are bragging, in part, that you get a 9.2 to 1 return on your investment in collecting unpaid taxes by expending 122.4.

What happens if you expend 150, 170, 250, 300? Will you get your 9.2? Does it diminish then to 2 to 1 only?

Mr. GIBBS. We have different factors at work here. We certainly can, from a theoretical standpoint, show you what the return would be for the additional dollar that is invested, and we can play it on out.

And frankly, from the standpoint of the amount of revenue out there that could be produced, you could take that on up.

Mr. THOMAS. And similarly you can reverse it. If you go down to only $90 million invested you would get perhaps a 20 to 1 return because you get the easy dollars first.

Mr. GIBBS. Correct.

Mr. THOMAS. How did you wind up at 122?

Mr. GIBBS. We wound up there from the standpoint of an overall budget presentation, as I mentioned, trying to balance the objectives of compliance on the one hand, customer service on the other, and providing funds to support technology to enhance our capability in both, within the administration's overall budget.

Now we also have another element at work in some of these areas, and that is our ability to absorb additional staff. In other words, we considered our ability to go out and recruit, train, and deploy additional people in these areas to produce the additional revenues.

Mr. THOMAS. Well, if you look at this chart, without additional information, I think one's immediate reaction is that if you get a 9.2 to 1 return on your dollars in collecting unpaid taxes, why wasn't there a reallocation from some other areas that do not do quite so well?

Mr. GIBBS. Because we are trying to balance our programs. If all we are looking for is dollars, Congressman, we could put a lot of folks in a particular area. But accounts receivable tend to be short-range and we have already identified those dollars. If we put more folks there, and neglect the examination area, then you are looking at the short-term and you may be sacrificing the long-term, if you are not going to support——

Mr. THOMAS. What you have in front of you is the Department's decision on allocation of resources to best serve needs?

Mr. GIBBS. That is correct.

Mr. DORGAN. Would you yield to me on that point.

Mr. THOMAS. Certainly.

Mr. DORGAN. I think that another area that is important to understand here is that OMB and Treasury also play a role in these recommendations. It is my understanding that the Internal Revenue Service had requested about 9,000 more positions, and I believe around 700 million additional dollars, and, Treasury cut that request. The OMB has a role in the question of how much they get, Treasury has a role in the question of how much that budget is pared back.

So, the simple answer to your question is that certainly there are diminishing returns out there some place. The IRS is nowhere near reaching that, particularly in the examination area, in my judgment at this point.

Mr. GIBBS. Mr. Dorgan, one comment on that. It is true we asked for additional positions, but quite frankly we got almost exactly what we asked for, or very close to it, on the compliance side, in terms of the resources that we asked for and were given.

Let me go quickly to the next chart. It is another way of showing you basically what the return will be over a 5-year period from investments on the compliance side.

I mentioned the $2.4 billion that will come in during fiscal year 1988. You will notice that this figure escalates, and this is on a cumulative basis. It escalates on up to $15.5 billion over the 5-year period through 1992. It goes up, incrementally, in stages of around $3 billion a year.

Passing to the next chart, it summarizes our responsibilities in our program areas for 1988. It shows that with the funds we re-

ceive, we will be processing 186 million tax returns which we expect to be filed. We will be handling 907 million information returns that we anticipate being filed.

It will permit us to issue 83 million refunds that we expect to issue. We will examine about 2 million returns, collect about 3.3 million delinquent accounts, secure 4.5 million delinquent returns, and, as I mentioned, collect a total tax revenue that we estimate at around $840 billion, of which approximately $50 billion is direct enforcement revenue.

Finally, I would like to move to the last chart which really summarizes, in a very graphic way, what the Internal Revenue Service has been doing over the period from 1980 to 1988.

The top line, in red, summarizes the returns filed, and what it basically shows is an increase from 1980 to 1988 of about 21 percent in returns filed. This is an important figure for us because, to a large extent, this is a barometer, an indicator of what our workload is, and what we are telling you is that our workload, has gone up 21 percent over this period.

The green shows the enforcement revenue that has been collected. Again, it will show that from 1980 to 1988, it has increased about 130 percent, and you can see how it has gone up over the years that are indicated. And those are in constant dollars.

The final thing shown here is our resources over this period. Our resources are shown in yellow, and basically what they show is that they have virtually stayed constant. When you compare them on a ratio basis to the amount of revenue collected, and look at them in terms of the 21 percent increase in the tax returns, what you actually see is a declining ratio.

The ratio of our resources to the revenue collected in 1980 was 14 percent. We anticipate it will be 10 percent in 1988. In short, it is one of the best ways that I can emphasize the effectiveness and the efficiency of the organization as we deal with an increasing workload and as we produce additional dollars.

Mr. Chairman, that concludes my testimony. I will be glad to answer questions.

[The statement of Mr. Gibbs follows:]

TESTIMONY OF
LAWRENCE B. GIBBS
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE

APRIL 23, 1987

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO BE HERE TO DISCUSS OUR FY 1988 BUDGET REQUEST AND SELECTED ASPECTS OF CURRENT IRS OPERATIONS. IN MY TESTIMONY, I WILL COVER THESE TOPICS AND PROVIDE AN OVERVIEW OF THE STRUCTURE AND STATUS OF TAX ADMINISTRATION TODAY.

WITH ME TODAY ARE A NUMBER OF OFFICIALS REPRESENTING VARIOUS SERVICE FUNCTIONS. WE WILL ALL BE AVAILABLE TO RESPOND TO QUESTIONS AT THE CONCLUSION OF MY TESTIMONY.

IRS' CHIEF COUNSEL, WILL NELSON, WILL BE APPEARING LATER TO DISCUSS THE SERVICE'S EFFORTS TO HELP REDUCE THE INVENTORY OF TAX SHELTER CASES IN IRS AND THE U.S. TAX COURT.

FILING SEASON REPORT

MR. CHAIRMAN, WHEN I LAST APPEARED BEFORE YOU IN FEBRUARY, IT WAS TOO EARLY TO PROVIDE MEANINGFUL DATA ON THE PROGRESS OF THE FILING PERIOD. THAT DATA IS NOW LARGELY IN AND I AM PARTICULARLY PLEASED TO REPORT THAT WE HAVE JUST CONCLUDED ONE OF THE BEST FILING SEASONS WE HAVE EVER HAD. WE HAVE PROCESSED MORE RETURNS AND ISSUED MORE REFUNDS WHILE AT THE SAME TIME MANAGING TO LOWER OUR SERVICE CENTER INVENTORIES. THROUGH APRIL 17TH, WE HAVE RECEIVED 89.2 MILLION INDIVIDUAL RETURNS AND PROCESSED 58.2 MILLION OF THEM, A PROCESSING INCREASE OF 2.1% OVER 1986'S TOTAL OF 57.1 MILLION FOR THE SAME PERIOD. THROUGH APRIL 16, WE HAVE ALSO CERTIFIED 46.3 MILLION REFUNDS, AN INCREASE OF .4% OVER 1986'S 46.1 MILLION. ALSO, THE TOTAL AMOUNT REFUNDED IS UP 1.4% OVER 1986, INCREASING FROM $37.6 BILLION TO $38.2 BILLION WHILE THE AVERAGE REFUND IS UP 1.0% FROM 1986'S $817.40 TO $825.58. OVER 34 MILLION TECHNICAL TAX LAW, REFUND, ACCOUNT OR FORMS REQUESTS WERE ALSO RESPONDED TO BY THE SERVICE. THIS INCLUDES MORE THAN 22 MILLION INQUIRES ON OUR TOLL-FREE TELEPHONE SYSTEM AND OVER 12 MILLION FORMS REQUESTS.

WE HAVE ALSO SEEN MAJOR POSITIVE CHANGES IN OUR ADJUSTMENT AND UNPOSTABLE INVENTORIES. AS OF APRIL 17, ADJUSTMENTS WERE 40.6% LOWER THAN A YEAR AGO, WHILE UNPOSTABLES DECLINED BY 60.3% FROM 1986 LEVELS. WE ARE CONTINUING TO CLOSELY MONITOR THESE AREAS TO BE CERTAIN THE IMPROVEMENTS DO NOT STOP NOW.

WHILE WE ARE PLEASED WITH THIS FILING PERIOD WE ARE NOT SATISFIED. WE RECOGNIZE THAT WE NEED TO DO A BETTER JOB IN ASSURING THE ACCURACY OF OUR RESPONSES TO TAXPAYERS AND WILL BE ADDRESSING THIS ISSUE PRIOR TO THE NEXT FILING SEASON.

COMPUTER OPERATIONS UPDATE

IN ADDITION TO THE COMPLETION OF A SUCCESSFUL FILING SEASON, I AM HAPPY TO SAY THAT ALL TAX PROCESSING SYSTEMS ARE FUNCTIONING PROPERLY. IN PARTICULAR, WE HAVE EXPERIENCED NO MAJOR PROBLEMS WITH THE EXISTING FRONT-END PROCESSORS. WE CONTINUE TO CLOSELY MONITOR THEIR PERFORMANCE AT EACH OF OUR SERVICE CENTERS, AND I AM SATISFIED WITH THE SUPPORT PROVIDED BY THE VENDOR IN ENSURING THEIR CONTINUED RELIABILITY UNTIL SUCH TIME AS THE UNITS ARE REPLACED.

I AM ALSO PLEASED TO REPORT THAT PROGRESS ON DEVELOPMENT OF THE COMMUNICATION REPLACEMENT SYSTEM (CRS), AND PARTICULARLY WITH THE REDESIGN OF THE COMMUNICATIONS SOFTWARE, IS PROCEEDING ON SCHEDULE. WE ARE WORKING CLOSELY WITH THE VENDOR TO ENSURE THAT THE FINAL PRODUCT SATISFIES OUR REQUIREMENTS AND WE HAVE BEEN RECEIVING REDESIGN DELIVERABLES ON A TIMELY BASIS.

ON APRIL 8, 1987, SYSOREX SUCCESSFULLY ACHIEVED THEIR SECOND BENCHMARK. THIS BENCHMARK INVOLVED RUNNING A PROTOTYPE SYSTEM OPERATIONAL CAPABILITY TEST ON THE NATIONAL COMPUTER CENTER'S CRS EQUIPMENT. THE CRS SUSTAINED AN AVERAGE OF 70 TRANSACTIONS PER SECOND FOR MORE THAN ONE HOUR USING THE TEST DATA AND PARAMETERS WHICH WILL BE USED AT THE ACTUAL TEST. THIS EXCEEDED THE CONTRACTUAL REQUIREMENT FOR 60 TRANSACTIONS PER SECOND. PREDICATED ON THIS SUCCESSFUL TEST AND THE TIMELY RECEIPT OF REDESIGN DELIVERABLES, WE ARE ON SCHEDULE FOR THE JUNE 15, 1987, ACTUAL TEST AT NCC.

IN ADDITION, NEW SOFTWARE HAS BEEN ACCEPTED BY THE SERVICE. THIS SOFTWARE ENABLED THE SERVICE TO BEGIN REPLACEMENT OF ANTIQUATED TERMINALS WITH NEW TERMINALS AT OUR PILOT TEST SITE AT THE FRESNO SERVICE CENTER, AND AT SOME OF THE OFFICE SITES WHICH ARE SUPPORTED BY FRESNO. FOLLOWING COMPLETION OF WHAT HAS BEEN TO DATE A SUCCESSFUL TEST OF THE NEW TERMINALS, WE WILL BEGIN THE IMMEDIATE NATIONWIDE REPLACEMENT OF OUR OLDER TERMINALS AT ALL REMAINING REMOTE SITES.

OVERVIEW

BEFORE GETTING INTO THE DETAILS OF OUR FY 1988 BUDGET REQUEST AND OPERATIONAL DATA, I WOULD LIKE TO BRIEFLY DISCUSS THREE BROAD PROGRAM EFFORTS WHICH ARE CENTRAL TO THE MANY ACTIVITIES IN WHICH WE ARE ENGAGED.

IRS AS A REVENUE CENTER

I BELIEVE IT GOES WITHOUT SAYING THAT WHILE TAX ADMINISTRATION MAY BE ONE OF THE LESS POPULAR FUNCTIONS OF GOVERNMENT, IT IS ALSO ONE OF THE MOST IMPORTANT, SINCE IT GENERATES THE REVENUES UPON WHICH THE OTHER FUNCTIONS OF GOVERNMENT DEPEND. OURS IS AN EFFICIENT TAX SYSTEM OVERALL, COSTING LAST YEAR ABOUT 49 CENTS PER $100 COLLECTED.

IT CAN BE AN EVEN MORE EFFECTIVE SYSTEM. THROUGH ADDITIONAL INVESTMENTS IN COMPLIANCE PROGRAMS THAT ULTIMATELY COLLECT TAX FROM THOSE WHO ARE NOT PAYING THEIR FAIR SHARE, WE INCREASE REVENUE AND MAKE THE SYSTEM A FAIRER ONE.

COST-BENEFIT ANALYSIS -- ADDITIONAL REVENUE FOR THE BUDGET DOLLAR INVESTED -- HAS BEEN A CORNERSTONE OF IRS' BUDGET REQUESTS FOR MANY YEARS. THE SERVICE HAS DONE ANALYSES AND DEVELOPED MODELS TO VERIFY AND PROJECT THE COST-BENEFIT RELATIONSHIP OF THE ANNUAL REVENUES FLOWING FROM A SPECIFIC INVESTMENT IN IRS ACTIVITIES. WE HAVE MET AND EXCEEDED REVENUE ESTIMATES ON PRIOR INITIATIVES, AND IN FACT, REVENUE FROM COMPLIANCE ACTIVITIES HAS MORE THAN DOUBLED IN THE LAST FEW YEARS. OVER THE YEARS, ACADEMICIANS, JOURNALISTS AND OTHERS OUTSIDE THE GOVERNMENT HAVE ENDORSED THIS CONCEPT TO SUPPORT THE NEED FOR ADEQUATE AND STABLE IRS FUNDING. IN ALL THESE AREAS, THE COST-BENEFIT RATIO INHERENT IN IRS BUDGETS HAS BEEN WELL-RECOGNIZED, AND THE DETAILS OF OUR BUDGET REQUEST, WHICH I WILL COVER SHORTLY, SHOW WHY.

IN SUMMARY, FURTHER INVESTMENTS IN TAX ADMINISTRATION CAN GENERATE ADDITIONAL REVENUE TO HELP SOLVE THE DEFICIT PROBLEM. THAT IS WHAT OUR BUDGET FOR 1988 PROPOSES. WHILE IT MAY NOT BE POSSIBLE TO COLLECT EVERY LAST DOLLAR OF TAX DUE -- AND EVEN

LESS LIKELY THAT IRS WOULD OR SHOULD BE FUNDED TO DO THAT -- WE BELIEVE IT MAKE SENSE TO COLLECT AS MUCH AS POSSIBLE OF THE AMOUNTS WE KNOW ARE DUE AND OWING NOW, FROM THOSE WHO HAVE NOT COMPLIED WITH THEIR TAX OBLIGATIONS.

BALANCED APPROACH REQUIRED

I BELIEVE THAT SUCCESSFUL TAX ADMINISTRATION REQUIRES BOTH FIRMNESS AND FAIRNESS IN ENFORCING THE LAW AND ACCURACY IN RESPONDING TO TAXPAYER REQUESTS FOR INFORMATION AND ASSISTANCE. WHEN WE COLLECT TAXES DUE FROM TAXPAYERS WHO ARE NOT COMPLYING, WE MUST BE PROFESSIONAL AND FAIR, BUT FIRM. AT THE SAME TIME, WE ALSO MUST PROVIDE BETTER SERVICE TO THE MAJORITY OF TAXPAYERS WHO ARE TRYING TO COMPLY BUT NEED OUR HELP TO DO SO. IF WE DON'T HELP TAXPAYERS WHO ARE TRYING TO COMPLY, IT MAY ULTIMATELY ERODE THE CONFIDENCE AND RESPECT TAXPAYERS HAVE IN OUR VOLUNTARY COMPLIANCE SYSTEM. THIS BALANCE IS ESSENTIAL TO THE LONG TERM HEALTH OF OUR TAX SYSTEM.

WHILE WE BELIEVE THESE TWO SIDES OF THE TAX ADMINISTRATION EQUATION -- COMPLIANCE AND SERVICE TO THE PUBLIC -- ARE RELATED IN A NUMBER OF WAYS, IT IS DIFFICULT TO PROVE. IN THE PAST THE REVENUE SERVICE HAS FOUND IT DIFFICULT TO DEMONSTRATE EMPIRICALLY THAT PROVIDING TAXPAYER SERVICE RESULTS IN BETTER COMPLIANCE. HOWEVER, A LACK OF STATISTICAL EVIDENCE DOESN'T NECESSARILY MAKE THE PROPOSITION ANY LESS TRUE.

LET ME GIVE YOU WHAT IS PERHAPS THE CLASSIC EXAMPLE OF HOW COMPLIANCE AND SERVICE ARE RELATED. IMAGINE YOU ARE A TAXPAYER WORKING ON YOUR 1986 RETURN. YOU COME ACROSS SOMETHING IN THE RETURN YOU DON'T UNDERSTAND, AND YOU CAN'T FIND AN ANSWER IN THE INSTRUCTIONS IN THE TAX PACKAGE OR IN ONE OF OUR PUBLICATIONS. YOU THEN DECIDE TO CALL OR VISIT AN IRS OFFICE FOR ASSISTANCE, ONLY TO FIND THAT -- THE TELEPHONE LINES ARE BUSY, OR THERE'S A ONE-HOUR WAIT FOR WALK-IN ASSISTANCE, OR THE ASSISTOR YOU FINALLY DEAL WITH IS UNABLE TO ANSWER YOUR QUESTION. WHAT DO YOU THINK YOUR REACTION WILL BE? IF WE'RE LUCKY, YOU'LL PERSIST UNTIL YOU GET AN UNDERSTANDABLE, CORRECT ANSWER. IF WE'RE UNLUCKY, YOU'LL GO AHEAD AND DECIDE THE QUESTION IN YOUR FAVOR -- WHICH MAY OR MAY NOT BE CORRECT.

WHAT THIS EXAMPLE TELLS US IS THAT IF WE DO NOT OR CANNOT DELIVER AN APPROPRIATE LEVEL OF SERVICE TO OUR CUSTOMERS, THE AMERICAN TAXPAYERS, WE MAY BE CONTRIBUTING DIRECTLY TO POTENTIAL NONCOMPLIANCE AND REVENUE LOSS. FOR THE LONG TERM, THEREFORE, WE NEED TO ASSURE A PROPER BALANCE AMONG OUR COMPLIANCE AND SERVICE PROGRAMS.

WE ALSO BELIEVE THAT IT IS IMPORTANT, WHEN FROM TIME TO TIME CUSTOMER SERVICE PROBLEMS DO ARISE, FOR US TO ADDRESS THEM PROMPTLY, FAIRLY, AND STRAIGHT-FORWARDLY. OUR GOAL IS TO MEET THE AMERICAN TAXPAYER'S REASONABLE NEEDS IN ALL OF OUR ACTIVITIES. BY EMPHASIZING THAT EACH OF US AT IRS IS RESPONSIBLE EVERY DAY FOR DEALING WITH TAXPAYERS PROMPTLY, ACCURATELY, FAIRLY, PROFESSIONALLY, AND COURTEOUSLY, WE ARE STRESSING A WILLINGNESS TO MAKE AN EXTRA EFFORT IN ALL OUR CONTACTS WITH THE PUBLIC.

PRESENT AND FUTURE COMPUTER SYSTEMS

WE ARE ACUTELY AWARE THAT THE COMPUTER SYSTEMS WE NOW HAVE IN PLACE FOR PROCESSING TAX RETURN INFORMATION WILL NOT MEET WORKLOAD DEMANDS IN THE 1990'S AND BEYOND. WE'VE PUSHED OUR SYSTEM THIS FAR, BUT IT SIMPLY CANNOT GO ON. THE OUTDATED DESIGN OF THE CURRENT COMPUTER SYSTEMS PLACES SIGNIFICANT CONSTRAINTS ON THE ABILITY OF THAT SYSTEM TO BEST SERVE TAXPAYERS. THIS IS NOT TO SAY THAT THE CURRENT SYSTEM DOES NOT PROVIDE ADEQUATE SERVICE TO TAXPAYERS -- IT DOES. BUT WE FEEL

THAT THE AMERICAN TAXPAYERS DESERVE MUCH BETTER THAN MERELY ADEQUATE SERVICE, AND WE WANT TO DO EVERYTHING POSSIBLE TO SEE THAT THEY HAVE IT. THE CURRENT SYSTEM IS STILL HEAVILY DEPENDENT ON LABOR-INTENSIVE, MANUAL PROCESSES. IT HAS INORDINATELY LONG PROCESSING TIMEFRAMES. IT RELIES TOO HEAVILY ON THE RETRIEVAL OF PAPER DOCUMENTS. IT CONTAINS REDUNDANT OR INCONSISTENT INFORMATION WHICH IS DIFFICULT TO PERFECT AND CROSS-INDEX. IT DOES NOT PERMIT EFFICIENT SOFTWARE DEVELOPMENT AND MAINTENANCE.

CLEARLY, THE SERVICE MUST TAKE ADVANTAGE OF NEW TECHNOLOGIES TO MAINTAIN AND IMPROVE ITS ABILITY TO PROCESS RETURNS, MAKE REFUNDS TIMELY, AND MAINTAIN TAXPAYER ACCOUNTS ACCURATELY IN THE FACE OF AN INCREASING TAX ADMINISTRATION WORKLOAD. AS A RESULT, THE SERVICE HAS BEEN CONCENTRATING ON THE REDESIGN AND INTEGRATION OF ITS COMPUTERIZED INFORMATION SYSTEMS UNDER THE AUSPICES OF WHAT WE CALL TAX SYSTEM REDESIGN (TSR).

THE KEY DESIGN CONCEPT BEHIND TSR CALLS FOR AN INFORMATION SYSTEM THAT WILL PROVIDE RAPID ACCESS TO TAX INFORMATION, AS OPPOSED TO THE PRESENT SYSTEM WHICH IS BASED UPON A DATA BASE MAINTAINED ON THOUSANDS OF MAGNETIC TAPES SEGMENTED IN VARIOUS MASTER FILES, SUCH AS OUR INDIVIDUAL MASTER FILE AND BUSINESS MASTER FILE. PROCESSING AND USING TAX INFORMATION AS IT IS CURRENTLY STORED FOR COMPLIANCE ACTIVITIES SUCH AS EXAMINATION AND COLLECTION IS A RELATIVELY SLOW PROCESS, AND IT IS DIFFICULT TO BRING ALL OF THE INFORMATION IRS HAS TOGETHER IN AN EFFECTIVE MANNER.

THE CENTRAL ELEMENT OF THIS NEW SYSTEM IS A "CORPORATE DATA BASE" THAT WILL ENCOMPASS ALL THE COMMONLY-USED INFORMATION FOR TAX ADMINISTRATION THROUGHOUT THE SERVICE. INFORMATION CONTAINED IN THE CORPORATE DATA BASE WILL INCLUDE TAXPAYER ACCOUNT INFORMATION, INFORMATION RETURNS FILES, PAPER DOCUMENT IMAGES, COMPREHENSIVE MANAGEMENT INFORMATION AND REFERENCE INFORMATION. THIS INFORMATION WILL BE AVAILABLE TO ALL OF THE SERVICE'S FUNCTIONS THROUGH A NATIONWIDE TELECOMMUNICATIONS NETWORK.

HOWEVER, EACH OF THE SERVICE'S FUNCTIONS -- INCLUDING EXAMINATION, COLLECTION, CHIEF COUNSEL, CRIMINAL INVESTIGATION AND TAXPAYER SERVICE -- HAS SPECIALIZED INFORMATION NEEDS. THIS KIND OF INFORMATION WILL BE AVAILABLE IN WHAT WE CALL "DEPARTMENTAL DATA BASE," WHICH WILL PROVIDE RAPID ACCESS TO INFORMATION NEEDED BY FIELD PERSONNEL TO MAXIMIZE THEIR EFFICIENCY IN PERFORMING THEIR DUTIES. THIS DEPARTMENTAL INFORMATION WILL BE FULLY INTEGRATED WITH CORPORATE INFORMATION, INSTEAD OF CONTINUING THE INDEPENDENT SYSTEMS WE HAVE NOW. THE AUTOMATED PROJECTS I REVIEWED FOR YOU EARLIER SERVE AS THE FOUNDATION FOR THE DEPARTMENTAL DATA BASES IN THE TSR PLAN.

AS YOU CAN SEE, THE DESIGN OF THE SYSTEM IS WELL UNDERWAY. IN FACT, WE EXPECT TO HAVE A COMPREHENSIVE MANAGEMENT PLAN DEVELOPED BY THE SPRING OF NEXT YEAR WHICH WILL LAY OUT IN DETAIL THE ACTIONS NECESSARY TO FULLY IMPLEMENT THE REDESIGNED SYSTEM I HAVE JUST DESCRIBED. I BELIEVE THE SERVICE IS MOVING AHEAD INTO THE FUTURE WITH CAREFUL PLANNING AND A CLEAR UNDERSTANDING OF WHAT WILL BE NEEDED TO MEET THE DEMANDS OF ADMINISTERING THE TAX LAWS IN THE 1990'S AND BEYOND.

FY 1988 BUDGET REQUEST

GIVEN THE THREE BROAD PROGRAM EFFORTS I HAVE JUST DESCRIBED, LET ME NOW OUTLINE THE MAIN FEATURES OF OUR FY 1988 BUDGET PROPOSALS. OUR BUDGET -- WHICH TOTALS $5.1 BILLION AND SOME 110,300 AVERAGE POSITIONS -- WILL INCREASE COMPLIANCE AND

GENERATE SUBSTANTIAL NEW REVENUE, ENHANCE OUR SERVICE AND ASSISTANCE TO TAXPAYERS, AND CONTINUE OUR INFORMATION SYSTEMS INITIATIVES. IN SHORT, OUR 1989 BUDGET IS INTENDED TO MEANINGFULLY ADDRESS THE THREE MAJOR ISSUES FACING IRS WHICH I HAVE JUST DISCUSSED. THE CHARTS ATTACHED TO THIS STATEMENT HIGHLIGHT SOME OF THE MAJOR COMPONENTS AND EXPECTED RESULTS OF OUR BUDGET REQUEST.

WE ARE PROPOSING A BUDGET THAT WILL COLLECT $840 BILLION OR MORE IN TAX REVENUES, INCLUDING $49 BILLION RESULTING FROM DIRECT ENFORCEMENT OF THE TAX LAWS, EXAMINING TAX RETURNS, COLLECTING UNPAID TAXES, SECURING DELINQUENT RETURNS, AND MATCHING INFORMATION REPORTS. INCLUDED IN OUR FY 1989 BUDGET IS AN INVESTMENT OF $400 MILLION WHICH WILL RESULT IN AN ADDITIONAL $2.4 BILLION BEING BROUGHT INTO THE TREASURY IN FY 1988. THIS ADDITIONAL REVENUE WILL HELP NARROW THE DEFICIT IN MEETING THE GRAMM-RUDMAN-HOLLINGS TARGET OF $108 BILLION.

IN ADDITION, WE WILL PROCESS 186 MILLION TAX RETURNS, ISSUE 83 MILLION REFUNDS, AND ASSIST OVER 60 MILLION TAXPAYERS. WE WILL INCREASE OUR ELECTRONIC FILING CAPABILITY AND EXPAND OUR COMPUTER ROOM CAPACITY AT OUR SERVICE CENTERS.

FINALLY, WE WILL EXPAND OUR INFORMATION SYSTEMS TO ENHANCE OUR COMPLIANCE AND TAXPAYER ASSISTANCE ACTIVITIES. ENHANCEMENTS INCLUDE CONTINUATION OF OUR COMPUTER INITIATIVES IN COLLECTION AND EXAMINATION, WHICH WILL GENERATE SIGNIFICANT NEW REVENUES, AND ADDITIONS TO OUR TAXPAYER ASSISTANCE PROJECTS.

COLLECTION OF ADDITIONAL TAX REVENUE

LET ME DESCRIBE WHAT MAKES UP OUR REVENUE INITIATIVES. AS THE SECOND PHASE OF A THREE-YEAR PLAN TO INCREASE THE EXAMINATION OF TAX RETURNS, OUR BUDGET WILL ADD 3,002 POSITIONS AND $121 MILLION. THIS CONTINUES THE INITIATIVE CONGRESS APPROVED LAST YEAR. IN 1988, THE SERVICE WILL EXAMINE 148,000 ADDITIONAL TAX RETURNS. OVER $10 BILLION IN ADDITIONAL REVENUE WILL BE COLLECTED BY 1992, OF WHICH $443 MILLION WILL BE COLLECTED IN 1988 FROM THIS SECOND INSTALLMENT.

AN INVENTORY OF OVER 158,000 DISPUTED TAX CASES ARE WAITING TO BE SETTLED IN APPEALS AND TAX LITIGATION. EMPHASIS NEEDS TO BE DIRECTED TOWARD CLOSING THESE CASES NOT ONLY TO REDUCE THE NUMBER OF CASES IN INVENTORY, BUT ALSO TO ACCELERATE THE COLLECTION OF TAX REVENUES BY $519 MILLION IN 1988. TO ACCOMPLISH THIS, WE ARE REQUESTING AN INCREASE OF 437 POSITIONS AND $22.9 MILLION FOR APPEALS AND TAX LITIGATION.

TO ENSURE FOLLOW-THROUGH ON CASES OF UNREPORTED INCOME DETECTED BY MATCHING INFORMATION RETURNS WITH INDIVIDUAL TAX RETURNS, WE ARE REQUESTING AN ADDITIONAL 1,362 POSITIONS AND $35.3 MILLION. THIS WILL ENABLE THE SERVICE TO REVIEW THREE MILLION MORE INCOME DISCREPANCY CASES IN FISCAL 1988. A TOTAL OF NINE MILLION MISMATCHES WILL BE REVIEWED THROUGH THIS PROGRAM, RESULTING IN UP TO FIVE MILLION TAXPAYER CONTACTS. OVERALL, DOCUMENT MATCHING WILL PRODUCE $3.8 BILLION IN ADDITIONAL TAX REVENUES, INCLUDING $224 MILLION FOR THIS NEW INITIATIVE.

THE ACCOUNTS RECEIVABLE PROGRAM AIMS AT COMPLETING ACTION ON UNPAID TAXPAYER ACCOUNTS, COLLECTING DELINQUENT TAX REVENUES OWED TO THE GOVERNMENT. TO SECURE AN ADDITIONAL $1.1 BILLION OWED BUT NOT PAID BY TAXPAYERS, WE ARE REQUESTING AN INCREASE OF 2,967 POSITIONS AND $122.4 MILLION.

Improve Tax Administration

January 24, 1986 was a milestone in the history of tax administration: the first successful transmission of tax return data from a tax return preparer to IRS. Electronic filing automates the steps of filling out and submitting a tax return to IRS and IRS receiving and processing that return. When the system is fully operational, it will allow taxpayers to file returns electronically from anywhere in the world. Tests have already been conducted in several metropolitan areas. Our request will make the system available to a larger number of taxpayers. Because electronically-filed returns bypass manual processing in the service center and go directly to the computer, staffing resources are being added to the service centers to ensure that the computer rooms are operating on schedule with no major problems.

Because of the enormous increase in demand by taxpayers for assistance in FY 1985 and FY 1986, the Service last year redirected resources from other programs to Taxpayer Service. As undesirable as this redirection may have been, it enabled us to have a successful filing season in FY 1986. Last year we assisted over 54 million taxpayers by telephone, by mail, or in our offices. We filled 8.5 million taxpayer orders in our centralized tax form distribution service. Our volunteer tax assistance, Community Outreach Tax Assistance and other education programs helped over 2 million taxpayers.

In the area of taxpayer education, the Service entered into cooperative agreements with 32 non-profit organizations to conduct Tax Counseling for the Elderly, and 20,000 volunteers helped 965,000 elderly taxpayers. Approximately 39,000 volunteers helped over 800,000 taxpayers through Volunteer Income Tax Assistance (VITA). Our taxpayer information efforts continued to be extensive and effective -- three TV tax clinics assisted nearly 8 million viewers, and print and electronic media releases carried an estimated advertisement value of $35 million.

Resources to process tax returns and assist taxpayers will increase to meet workload demands. Current estimates indicate that almost 185 million returns will be processed in FY 1988, an increase of 4.3 million tax returns. The Service will continue its toll-free telephone, walk-in, and correspondence programs, as well as provide tax law information and group tax return preparation at community locations, including $2.4 million in tax counseling for those over 60. Over 60 million taxpayers will receive some tax assistance from IRS next year.

Information Systems Initiatives

We must use computers and information tools to improve the effectiveness of personnel working in compliance and taxpayer assistance activities. Increased automation within the Service will improve our contacts with taxpayers by increasing our productivity.

The taxpaying public is accustomed to getting information from banks, insurance companies, and other organizations in a matter of minutes. IRS must be able to respond more quickly and accurately to taxpayers. This is why modernization of our systems is so important.

To become more efficient as we provide more effective assistance to taxpayers, in FY 1988 we intend to pilot test the Automated Taxpayer Service System (ATSS). This technology addresses, and it intended to minimize, the additional costs of providing better assistance. It does so by giving each

ASSISTOR IMMEDIATE ACCESS TO: (1) A TAX REFERENCE DATA BASE PROVIDING ACCURATE TAX LAW AND PROCEDURAL ASSISTANCE, AND (2) TAXPAYER ACCOUNT INFORMATION WITH LITTLE OR NO NEED FOR SUBSEQUENT CONTACT WITH THE TAXPAYER. BY USING THIS APPROACH, WE ESTIMATE THAT THE COST OF MOST TRANSACTIONS CAN BE SIGNIFICANTLY REDUCED.

THE AUTOMATED EXAMINATION SYSTEM (AES) IS PROVIDING REVENUE AGENTS WITH PORTABLE COMPUTERS TO ACCESS TECHNICAL INFORMATION ON A TAXPAYER'S CASE, PERFORM TAX COMPUTATIONS, AND PREPARE EXAMINATION AUDIT REPORTS. DURING OUR NEXT PHASE, DESKTOP/MINICOMPUTERS WILL BE PROVIDED TO TAX AUDITORS AND EXAMINERS. WE ANTICIPATE OVER $10 BILLION IN REVENUE FROM THIS SYSTEM OVER ITS LIFE.

THE REPLACEMENT OF COLLECTION OFFICE PROCEDURES WITH THE AUTOMATED COLLECTION SYSTEM (ACS) RESULTED IN IRS SAVING 1,700 POSITIONS A YEAR. IT REDUCED THE COST OF CLOSING A DELINQUENT ACCOUNT FROM $50 TO $13, BRINGING IN AN ADDITIONAL $50 MILLION IN REVENUE IN FISCAL 1985. THE SUCCESS OF ACS HAS RESULTED IN THE DECISION TO AUTOMATE THE REST OF COLLECTION. THIS EFFORT, WHICH WE REFER TO AS THE INTEGRATED COLLECTION SYSTEM (ICS), WILL AUTOMATE CASE FILES AND THE STEPS IT TAKES TO PROCESS THOSE FILES. WE ESTIMATE THIS NEW SYSTEM HAS THE POTENTIAL TO BRING IN AN ADDITIONAL $2 BILLION IN REVENUE OVER ITS LIFETIME.

INCREASING IRS' BUDGET FLEXIBILITY

AS YOU MAY KNOW, THE FEDERAL BUDGET PROCESS REQUIRES THAT WE DEVELOP OUR RESOURCE NEEDS EIGHTEEN MONTHS BEFORE THE BEGINNING OF EACH FISCAL YEAR. THIS TIME FRAME PERMITS ADMINISTRATION AND CONGRESSIONAL REVIEW BEFORE THE START OF THE FISCAL YEAR. HOWEVER, IT ALSO MAKES RESOURCE AND WORKLOAD PROJECTIONS DIFFICULT, PARTICULARLY IN FY 1988 BECAUSE WE CAN NOT FULLY ANTICIPATE THE IMPACT OF TAX REFORM AND OUR EFFORTS TO REDUCE OUR SERVICE CENTER INVENTORIES ON THE LEVEL OF DEMAND BY TAXPAYERS FOR OUR ASSISTANCE IN TAXPAYER SERVICE.

BECAUSE OF THE UNCERTAINTIES OF THE PROCESS, IT IS DESIRABLE THAT WE OBTAIN MORE FLEXIBILITY IN FY 1988 TO PROPERLY ALLOCATE OUR RESOURCES. AS I'VE TESTIFIED BEFORE THE APPROPRIATIONS COMMITTEES, THE INTERNAL REVENUE SERVICE IS SEEKING FIVE PERCENT AUTHORITY TO REALLOCATE OUR RESOURCES BETWEEN OUR FOUR OPERATING APPROPRIATIONS. MOST AGENCIES, INCLUDING ALL THE OTHER TREASURY BUREAUS, HAVE ONE APPROPRIATION FOR OPERATING EXPENSES. THE INTERNAL REVENUE SERVICE HAS FOUR SEPARATE APPROPRIATIONS. WITHOUT SPECIFIC AUTHORIZATION, WE CANNOT REDIRECT STAFF OR FUNDS TO MEET SHIFTS IN WORKLOAD DEMANDS OR MANDATORY COST INCREASES. CURRENTLY, IRS HAS TRANSFER AUTHORITY OF ONLY ONE PERCENT.

IN FISCAL YEAR 1986, CONGRESS APPROVED FIVE PERCENT TRANSFER AUTHORITY, AS PART OF THE SUPPLEMENTAL APPROPRIATIONS ACT, FOR IRS TO MEET WORKLOAD DEMANDS IN TAXPAYER SERVICE AND RETURNS PROCESSING. USING THIS AUTHORITY, IRS TRANSFERRED $13 MILLION INTO TAX PROCESSING AND $9 MILLION INTO TAXPAYER SERVICE FROM OTHER PROGRAMS.

BY AGAIN PERMITTING IRS TO TRANSFER LIMITED RESOURCES IN 1988, UP TO FIVE PERCENT, CONGRESS WILL BE GIVING THE SERVICE GREATLY IMPROVED ABILITY TO MEET THESE CHALLENGES. IN DOING SO, THE CONGRESS WOULD ALSO GIVE IRS THE FLEXIBILITY MOST AGENCIES ALREADY HAVE. MOREOVER, IT WILL ALLOW US TO DEAL MORE EFFECTIVELY WITH UNFORESEEN NEEDS IN ORDER TO PROVIDE BETTER SERVICE TO YOUR CONSTITUENTS WHO ARE OUR CUSTOMERS.

THE TAX REFORM ACT OF 1986

THE TAX REFORM ACT OF 1986, PUBLIC LAW 99-514, REPRESENTS A SWEEPING CHANGE FROM EARLIER LAW. CONTAINING EIGHTEEN TITLES, WITH OVER 300 PROVISIONS, THE ACT IS THE MOST SIGNIFICANT TAX LEGISLATION IN THE LAST THIRTY YEARS, AND SOME SAY IN THE HISTORY OF OUR TAX LAWS. IT IS CRUCIAL THAT WE PROPERLY PUT INTO PLACE THE PROVISIONS ENACTED BY CONGRESS. EFFECTIVE IMPLEMENTATION OF THE ACT IS A HIGH PRIORITY OF MINE AND THE KEY TO TAXPAYERS COMPLYING WITH THE NEW LAW.

PLANNING FOR IMPLEMENTATION OF THE NEW LAW BEGAN LONG BEFORE I BECAME COMMISSIONER. THROUGHOUT THE 30 MONTHS OF DEVELOPMENT AND CONGRESSIONAL CONSIDERATION OF THE TAX REFORM LEGISLATION, IRS TRACKED EACH PROPOSAL TO ASSESS ITS POTENTIAL IMPACT ON OUR CURRENT SYSTEMS AND ON TAXPAYERS. LAST SUMMER WE PUT INTO PLACE A DUAL COMPUTER PROGRAMMING SYSTEM, ONE TO DEVELOP SOFTWARE CHANGES UNDER THE OLD LAW AND ANOTHER IN CONTEMPLATION OF THE CHANGES THAT WOULD GO INTO EFFECT JANUARY 1, 1987, UNDER THE NEW LAW.

SINCE PASSAGE OF THE ACT, WE HAVE PREPARED A DETAILED PLAN TO IDENTIFY EVERY ACTION THAT MUST BE ACCOMPLISHED AND TARGET DATES BY WHICH THAT ACTION MUST BE COMPLETED. IT IS IMPORTANT TO UNDERSTAND THAT IN A LARGE, MULTI-DIMENSIONAL ORGANIZATION SUCH AS IRS, ONE PROCESS DEPENDS UPON THE TIMELY COMPLETION OF ANOTHER. SINCE THE NEW TAX REFORM LEGISLATION MAY ULTIMATELY AFFECT OVER 500 OF OUR FORMS, HUNDREDS OF OUR AUTOMATED PROGRAMS, AND THOUSANDS OF OUR INTERNAL PROCEDURES, YOU CAN SEE THAT CAREFUL AND PRECISE PLANNING IS ABSOLUTELY NECESSARY.

IN ADDITION, I HAVE ESTABLISHED A CONTROL GROUP OF SELECTED IRS OFFICIALS WHOSE ROLE IS TO ADVISE ME ON THE PROGRESS OF PLANNING FOR IMPLEMENTATION, AND BRING TO MY ATTENTION THOSE ISSUES REQUIRING POLICY DECISIONS ON CONTROVERSIAL ISSUES OR PROGRAMS AFFECTING MULTIFUNCTIONAL OPERATIONS. A SYSTEM OF PRE-IDENTIFIED MILESTONES HAS BEEN DEVELOPED TO ASSURE ME THAT IRS IS IMPLEMENTING EACH ACTION IN A TIMELY FASHION AND THAT I WILL RECEIVE EARLY WARNINGS OF PROBLEMS.

AS YOU ARE AWARE, THE ACT WILL BE IMPLEMENTED OVER A THREE-YEAR PERIOD, BEGINNING IN FY 1987. THIS ENTAILS SIGNIFICANT ADDITIONAL COSTS TO THE IRS. IN ORDER TO MEET THESE ADDITIONAL COSTS, AND STILL MAINTAIN PROGRAM LEVELS APPROVED BY THE CONGRESS, WE HAVE REQUESTED A SUPPLEMENTAL OF $80 MILLION IN FY 1987 ASSOCIATED WITH TAX REFORM.

WHILE ALMOST EVERY PROVISION OF THE ACT HAS AN EFFECT ON IRS OPERATIONS, CERTAIN TITLES HAVE A MORE SIGNIFICANT IMPACT IN TERMS OF THEIR IMPLEMENTATION COSTS. FIRST, THE CHANGE IN THE BASIC RATE STRUCTURE, WHICH REDUCES TAX RATES AND INCREASES THE STANDARD DEDUCTION AND PERSONAL EXEMPTION AMOUNTS, RESULTS IN A REDUCTION IN THE NUMBER OF INDIVIDUALS WITH A TAX LIABILITY. SOME INDIVIDUALS WILL STILL FILE A RETURN IN ORDER TO OBTAIN A REFUND OR CLAIM THE EARNED INCOME CREDIT. IN ADDITION, THE REQUIREMENT THAT CHILDREN WITH EARNED INCOME OVER $500 PLUS $1 OR MORE OF UNEARNED INCOME BE TAXED AT THE HIGHER OF THEIRS OR THEIR PARENTS' MARGINAL TAX RATE WILL REQUIRE MORE CHILDREN TO FILE, FURTHER OFFSETTING ANY POTENTIAL REDUCTION IN THE NUMBER OF RETURNS TO BE FILED. CHANGES IN TAX FORMS AND FILING REQUIREMENTS APPLICABLE TO CHILDREN WHO WILL BECOME TAXPAYERS UNDER THESE NEW PROVISIONS WILL NECESSITATE EXTENSIVE REPROGRAMMING OF IRS COMPUTER SYSTEMS. NEW CODES ALSO WILL HAVE TO BE ADDED TO THE RETURNS PROCESSING CYCLE TO MAKE CERTAIN, FOR EXAMPLE, THAT PARENTS IN THEIR TAX RETURNS HAVE IDENTIFIED SOCIAL SECURITY NUMBERS FOR ALL OF THEIR DEPENDENTS OVER AGE FIVE, WHICH WILL SUBSTANTIALLY INCREASE THE WORKLOAD IN PROCESSING TAX FORMS.

TO OBTAIN THE HIGHEST COMPLIANCE POSSIBLE WITH THE NEW LAW, IRS MUST INFORM THE PUBLIC OF THE MANY CHANGES TAX REFORM BRINGS ABOUT. INFORMING THE PUBLIC IS KEY TO EFFECTIVE IMPLEMENTATION. FAILURE TO PROVIDE HIGH QUALITY, ASSISTANCE AND SERVICE TO THE PUBLIC MAY ERODE THE CONFIDENCE AND RESPECT AMERICAN TAXPAYERS HAVE IN OUR TAX SYSTEM, RESULTING IN DECREASES, OVER THE LONG TERM, IN THE LEVELS OF VOLUNTARY COMPLIANCE.

FOR THIS REASON, WE HAVE MADE A SPECIAL EFFORT TO PROVIDE TIMELY GUIDANCE ON TAX REFORM TO TAXPAYERS THROUGH OUR REGULATIONS AND RELATED INFORMATION VEHICLES. AS OF APRIL 15, IRS HAD ISSUED 20 REGULATIONS, 30 NOTICES, 22 ANNOUNCEMENTS, 35 NEWS RELEASES, 15 REVENUE RULINGS, ONE REVENUE PROCEDURE, AND ONE TREATY ON THE 1986 ACT. THESE ITEMS COVERED A WIDE VARIETY OF TOPICS.

OUR FIELD OFFICES WILL BE COVERING THE TAX REFORM ACT IN ALL SESSIONS OF THE PRACTITIONER INSTITUTES AND THE SMALL BUSINESS WORKSHOPS THEY CONDUCT. WE PROVIDED VOLUNTEERS IN OUR VOLUNTEER INCOME TAX ASSISTANCE (VITA) AND TAX COUNSELING FOR THE ELDERLY (TCE) PROGRAMS WITH A SPECIAL ADDENDUM TO PUBLICATION 679, "VOLUNTEER ASSISTOR'S GUIDE", WHICH GIVES INFORMATION ON THE ACT.

WE ARE USING TELEVISION AND RADIO PROGRAMS EXTENSIVELY TO REACH LARGER AUDIENCES. PUBLIC SERVICE ANNOUNCEMENTS ON THE "NEW TAX LAW" ARE APPEARING NOW ON 300 TELEVISION STATIONS AND 7,000 RADIO STATIONS NATIONWIDE. A TWO-HOUR SHOW ENTITLED "TAX BREAK '87", DEALING WITH ASPECTS OF THE NEW LAW, AIRED ON PUBLIC TELEVISION ON FEBRUARY 1, AND WE HAVE DISTRIBUTED A VIDEO NEWS RELEASE AND RADIO NEWS PACKAGES TO STATIONS NATIONWIDE. IN THE FALL, WE PLAN ANOTHER SHOW SIMILAR TO "TAX BREAK '87" WHICH WILL FOCUS EXCLUSIVELY ON THE TAX REFORM ACT.

WE HAVE DISTRIBUTED TAX REFORM ACT "CLIPSHEETS" OF CAMERA-READY COPY TO THE PRINT MEDIA, AND WE HAVE MARKETED DROP-IN ADS TO TIME, NEWSWEEK, PEOPLE, AND OVER 1,500 SPECIALIZED MEDIA SOURCES. WE ALSO PLAN TO HAVE TWO NEW PUBLICATIONS AVAILABLE IN LATE APRIL -- ONE DEALING WITH THE EFFECT OF THE TAX REFORM ACT ON INDIVIDUALS, THE OTHER ON BUSINESSES. IN MAY, DRAFT VERSIONS OF NEXT YEAR'S FORMS 1040, 1040A, AND 1040EZ WILL BE RELEASED FOR PUBLIC REVIEW AND COMMENT.

MR. CHAIRMAN, WE'VE BEEN WRITING TO YOU DURING THE PAST MONTH TO KEEP YOU ADVISED OF OUR PROGRESS IN PRODUCING AND DISTRIBUTING THE NEW FORM W-4A. OUR LATEST FIGURES INDICATE THAT 130 MILLION SINGLE CUT SHEET W-4A'S HAVE GONE TO OUR REGIONAL DISTRIBUTION CENTERS AND ANOTHER 6.6 MILLION W-4A FORMS PACKAGES HAVE GONE TO EMPLOYERS. WE ESTIMATE THAT OVER HALF OF ALL EMPLOYEES HAVE NOW PROVIDED THEIR EMPLOYERS WITH NEWLY COMPLETED FORMS W-4 OR W-4A.

IT IS ALSO ESSENTIAL THAT THE SERVICE TRAIN ITS TECHNICAL WORKFORCE IN THE LAW. TRAINING IS UNDERWAY TO ACQUAINT IRS PERSONNEL WITH THE MANY PROVISIONS THE NEW LAW CONTAINS. TRAINING COURSES ALSO WILL HAVE TO BE REVISED TO IMPROVE TELEPHONE ASSISTORS' TAX SKILLS AND COMMUNICATION ABILITIES. OUR QUALITY REVIEW STAFF WILL ALSO BE MAKING CALLS TO TOLL-FREE SITES TO ASSESS THE QUALITY OF TELEPHONE SERVICE AND SUPERVISORS WILL MONITOR CALLS AT THE SITES AS A REGULAR PART OF THEIR MANAGEMENT RESPONSIBILITIES. FURTHER, ALL TAXPAYER SERVICE SPECIALISTS HAVE BEEN TRAINED ON THE TAX REFORM ACT OF 1986, AND ALL TAXPAYER SERVICE ASSISTORS HAVE BEEN GIVEN AN OVERVIEW OF THE ACT. IN FACT, IN RECENT YEARS, TAXPAYER SERVICE ALONE HAS MORE THAN DOUBLED THE AMOUNT OF TRAINING PROVIDED TO ITS EMPLOYEES.

REVENUE AGENTS, TAX AUDITORS, AND TAX EXAMINERS WILL RECEIVE ONE-DAY OF AWARENESS TRAINING ON THE NEW PROVISIONS. THIS WILL PROVIDE EXAMINATION PERSONNEL WITH INFORMATION NEEDED TO COPE WITH CHANGES IN THE TAX LAWS WHEN DEALING WITH TAXPAYERS AND THEIR REPRESENTATIVES. AN OVERVIEW OF ALL PROVISIONS OF THE TAX REFORM ACT WILL BE CONDUCTED FOR THE APPEALS, TAX LITIGATION, AND ENFORCEMENT LITIGATION FUNCTIONS IN CHIEF COUNSEL. A THREE-DAY COURSE TARGETED AT SPECIFIC AREAS OF THE LAW WILL BE HELD FOR THE TECHNICAL AREA. SEVERAL COURSES CONCENTRATING ON THE FOREIGN PROVISIONS OF THE ACT WILL BE DEVELOPED FOR REVENUE AGENTS, TAX AUDITORS, AND THE REVENUE OFFICERS IN THE INTERNATIONAL PROGRAM. FINALLY, COLLECTION IS PREPARING TRAINING MATERIALS TO MAKE THEIR EMPLOYEES FAMILIAR WITH THE NEW INTEREST AND PENALTY PROVISIONS.

THE INTERNAL REVENUE CODE PROVISIONS DEALING WITH EMPLOYEE BENEFIT PLANS HAVE ESSENTIALLY BEEN REWRITTEN BY THE TAX REFORM ACT. APPROXIMATELY 20 PERCENT OF THE ACT DEALS WITH EMPLOYEE PLANS. IRS WILL BE REQUIRED TO REVIEW ABOUT 665,000 PLANS BEGINNING THIS FISCAL YEAR AND ISSUE LETTERS STATING IRS' DECISION ON THE VALIDITY OF THE PLAN WITHIN THE NINE-MONTH PERIOD REQUIRED BY LAW. PROVISIONS INSTITUTING NEW EXCISE TAXES AND EXTENDING THE SCOPE OF CERTAIN EXISTING TAXES RELATED TO PENSION PLANS BECOME EFFECTIVE IN CALENDAR YEAR 1987, AND ARE SIGNIFICANT TO REVENUE COLLECTION.

CONCLUSION

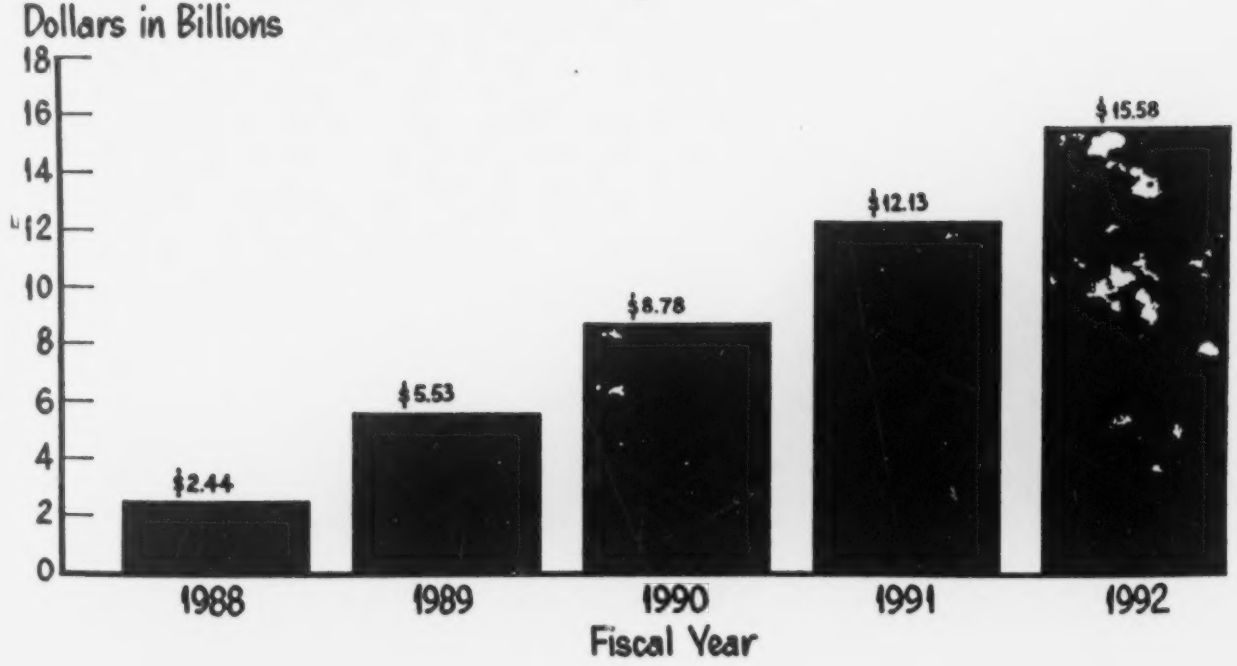
MR. CHAIRMAN, I'VE COVERED A LOT OF GROUND TODAY ON A WIDE VARIETY OF SUBJECTS, BUT I BELIEVE A GREAT DEAL OF IMPORTANT INFORMATION HAS BEEN PRESENTED. MY ASSOCIATES AND I WILL BE PLEASED TO TRY TO ANSWER ANY QUESTIONS YOU OR THE MEMBERS MAY HAVE.

Internal Revenue Service
FY 1988 Initiatives

Return on Investment
FY 1988 Budget
(Dollars in Millions)

Purpose:	Investment	Return (Revenue)	Return on Investment
Determining Tax Liabilities	$226.6	$1,091	4.8 to 1
Collecting Unpaid Taxes	122.4	1,125	9.2 to 1
Document Matching	35.3	224	6.3 to 1
	$384.3	$2,440	6.4 to 1

I.R.S. FY 1988 Revenue Initiatives
Cumulative Collections through FY 1992



IRS Program Responsibilities, FY 1988

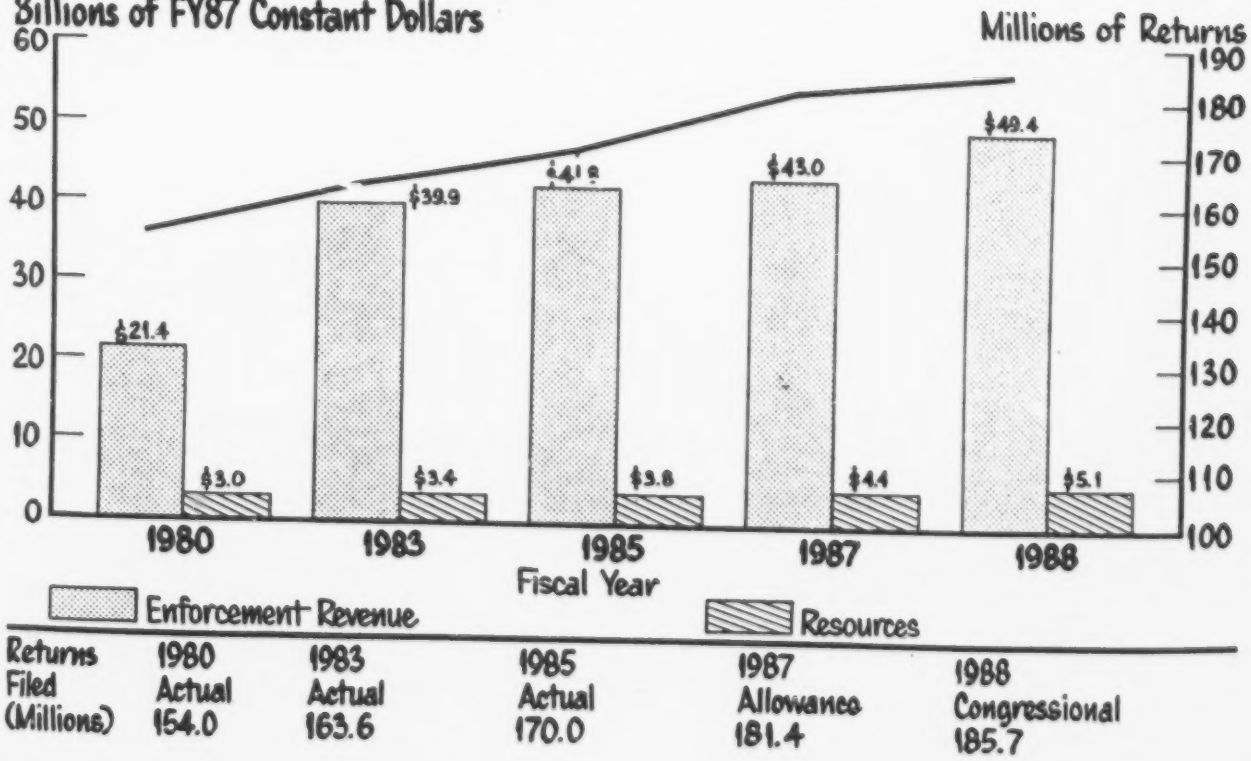
Tax Returns Filed	186 Million
Information Returns Filed	907 Million
Refunds Issued	83 Million
Taxpayers Assisted	60 Million
Returns Examined	2 Million
Delinquent Accounts Collected	3.3 Million
Delinquent Returns Secured	4.5 Million
Total Tax Revenue	$840 Billion
Direct Enforcement Revenue	$ 49 Billion

Major Partner in Drug Enforcement

IRS Major Partner in Drug Enforcement

- Contributes 1,725 positions and $85 million to drug enforcement; staffing growth of 90% since 1981.
- Participates in all 13 OCDE task forces.
  - IRS is involved in 2 out of every 3 cases; second only to DEA.
  - 1,600 indictments, 1,100 convictions.
- Participates in Operation Alliance; Southwest Border.
  - Money laundering and currency exchange.
  - 30 indictments, 24 convictions.

Internal Revenue Service



Returns Filed (Millions)	1980 Actual	1983 Actual	1985 Actual	1987 Allowance	1988 Congressional
	154.0	163.6	170.0	181.4	185.7

Chairman PICKLE. Commissioner, we have several questions to ask you, but with respect to the last chart, the green column shows the number of returns that have actually been handled, or is it the money that has been brought in by you?

Mr. GIBBS. It is the money that is brought in through our enforcement programs, such as examination, collection, and document matching.

Chairman PICKLE. It goes from 1980 to—what is that figure?

Mr. GIBBS. $21.4 billion.

Chairman PICKLE. $21.4 billion, up to?

Mr. GIBBS. $49.4 billion in 1988.

Chairman PICKLE. All right. Now, if that is the additional money you are getting, can you furnish me, if you do not have it now, the rate of compliance that we are faced with.

What is the rate of compliance now?

Mr. GIBBS. I can furnish you with that, Mr. Chairman, if you would like.

Chairman PICKLE. But is it growing, or getting less?

Mr. GIBBS. In the individual area, our compliance levels—based on recent studies that we have done, and we will be glad to furnish you with the information—appear to be increasing slightly.

Chairman PICKLE. Well, I would want to know what percentage it is.

Mr. GIBBS. All right.

Chairman PICKLE. I would like to have a chart showing what it has gone to from, say, 1980 to this same period of time, and if we are facing an alarming problem in that area of a growing lack of compliance. I want to know what those rates are.

Will you furnish that to the Committee.

Mr. GIBBS. I will be glad to.

[The information follows:]

VOLUNTARY COMPLIANCE LEVELS

The compliance rate estimates shown below indicate, for each year, estimated amounts of income taxes voluntarily paid as a percentage of total amounts of income taxes owed. The estimates include individual and corporate taxes due on incomes earned in the legal sector of the economy. They include both filers and nonfilers, and they include nonreporting of taxes due as well as nonpayment of taxes voluntarily reported as due.

Income tax compliance rate estimates

Tax year:	*Compliance rate (percent)*
1981	80.7
1982	80.3
1983	80.9
1984	81.3
1985	81.6
1986	81.5
1987	81.3
1988	81.0

These estimates were made in 1983 and were based in part on Taxpayer Compliance Measurement Program (TCMP) data from the 1965, 1969, 1973, and 1976 TCMP studies of individual taxpayers. We are now revising and extending our tax compliance estimates to incorporate data from the 1979 and 1982 TCMP studies, as well as from other sources.

Mr. GIBBS. But generally, it is turning around, and has been since 1982.

Chairman PICKLE. All right. Now I look at that chart, and the ones you gave before on the compliance, and you stated that you really had gotten all you had asked for in the compliance field with respect to approval from OMB. Yet you had asked for about 9,000 more employees than OMB gave you in the congressional budget submission.

Now the question that comes to my mind, of course, is, what really lost out then, if you did not get all those employees and you got all you wanted from compliance? Did taxpayer services or did processing returns lose out?

Mr. GIBBS. The principal programs where we requested additional funds were in the tax-processing area—in our service centers, in our taxpayer service area, and in our criminal investigation area. Those were the three principal areas.

Chairman PICKLE. Say that again, please.

Mr. GIBBS. The three principal areas where we requested the additional employees were in the tax-processing or service center area, the taxpayer service areas, and also in our criminal investigation area.

Chairman PICKLE. All right. So those are the three areas you did not get what you wanted, and have problems there? Is that correct?

Mr. GIBBS. We did not get the full request in these areas, but as I will explain—and I will be glad to explain—one of the things that we have been given in these areas—and particularly in the taxpayer service area, is the right to transfer funds if we find that it is appropriate.

If I could, Mr. Chairman, let me explain what we are saying here. As we came out of the 1985 filing season, we had huge inventories, and we found that, particularly in the service centers and in the taxpayer service area, we had substantial needs, and those needs were funded to a very large extent last year with the help of this committee.

Now as we have worked through the adjustments, and the problems that have come out of the 1985 filing season, one of the things that we are finding—and remember that we did these estimates that we are talking about now, a year and a half ago, or longer—is that as the inventories come down, we are having a difficult time trying to anticipate what our workload is going to be in the centers and also in taxpayer service.

Because remember that, particularly in taxpayer service, two-thirds of the work we do each fiscal year relates to taxpayer accounts, not questions about the tax law. Historically, that is what it has been. Now as the inventories come down, as the adjustments are addressed——

Mr. THOMAS. Commissioner, what are inventories?

Mr. GIBBS. Excuse me.

Mr. THOMAS. Why don't we call them what they are.

Mr. GIBBS. Fine. I am sorry. The inventories we are talking about are the adjustments that we are making to taxpayers' returns, the situations where tax returns do not go through our systems and we cannot post them to taxpayers' accounts. Some of the inventories are cases arising from the problems we had in 1985. And they are categorized in various ways. Pardon me for the jargon, but that is basically what our inventories are.

Mr. THOMAS. Okay. Thank you.

Mr. GIBBS. Those inventories are coming down. And what we are saying is, given the difficulty of trying to forecast what a future inventory level is going to be, what its impact is going to be on returns processing in the service centers, and on taxpayer service, we came up with a budget that includes certain staffing increases. Then, in addition, the administration has recognized that we cannot predict what is going to happen in tax reform and what is going to happen with respect to taxpayer accounts, and has authorized the flexibility to transfer additional funds in if we need them. That basically is the thrust of the administration's budget in this area, Mr. Chairman.

Chairman PICKLE. All right. Thank you, Commissioner. The Chair is going to yield first to Mr. Dorgan for any questions he might have of you, Commissioner.

Mr. DORGAN. Mr. Chairman, I would like to address a general question to the Commissioner about where we are with respect to the rate of compliance and the tax gap.

I would not want people to think by your remarks that everything is fine out there. My own judgment is that there has been a rather serious diminution in the capability of the Internal Revenue Service to enforce the growing number of returns that are filed, that is, enforce the compliance with the Tax Code, and properly audit the growing number of returns that have been filed.

I think you know, Commissioner, that we have seen the percentage of audits decrease rather alarmingly over the years. We have seen some significant problems in the whole enforcement area, and we have had a virtual explosion—notwithstanding Mr. Stockman's, and others' insistence we did not—an explosion of shelters and limited partnerships created solely for the purpose of evading tax responsibilities or avoiding their tax obligations.

Because of that, I sense we have got a very serious problem in terms of the view people have of the IRS and its ability to enforce the laws, and the budget problem that has stemmed I think from neglect in recent years.

And while I have indicated to you previously, and I would reiterate today, that I think you are doing a marvelous job down there in turning around attitudes, and trying to turn around the IRS itself on some of these issues. But, I do not want people to think that we do not have a problem.

In my judgment we have got a very serious problem that is going to take a long while to correct.

We have got a problem in restoring our ability to adequately audit. We have got a problem in offering to the American people the type of help and assistance they ought to expect from the IRS. All of that creates the tax gap which now is over $100 billion, and according to estimates is expected to grow to over $200 billion.

So I would like you to respond to that. I got the feeling you were trying to say to us things are much, much better.

I think they are going to get much, much better, hopefully in part because of your leadership, but I think things require a great deal of your and our attention in order to get them to that point.

Mr. GIBBS. Mr. Dorgan, thank you for that question because it does permit me to testify where I am coming from. As you point out, the tax gap, that is, the difference between taxes owed and taxes paid, has been increasing in this country, and we project that it will continue to increase. Today over $100 billion. It is also true that our audit coverage, the percentage of examinations to returns filed, has been going down in this country, and it is below 2 percent today. That is about half, or less than half, of what it was when I was here 10 years ago. I am concerned about that.

I would also like to point out, however, in fairness, that in addition to audit coverage, we are doing some things today that we were not doing 10 years ago in the document matching area, and also in cooperation with the States in terms of exchanging the information and more efficiently using the resources that we and they have.

So audit coverage, although important, is not the entire picture of what our presence is out there in the compliance area today. I think it is getting better, but I would like to see it increase.

What I am enthusiastic about, what I appreciate as a tax administrator, is that I think this is being recognized in terms of the funds that we received this year in the compliance area, and that we are going to be receiving next year in terms of the commitment of both the administration and Congress to fund the Internal Revenue Service to address these issues.

Mr. DORGAN. Originally, the responsibility to respond to our annual tax obligation was a simple civic duty and now, I think for a lot of Americans, it has become an April nightmare.

What should be a very simple civic duty has turned into something much, much more difficult and complicated than that, and requires most people to go hire somebody to help them.

I think we have a responsibility to expand IRS services to help the American people. You just addressed that a minute ago, and I think what you were saying is that the original budget requests would have responded to the taxpayer service needs, but you did not get these substantial resources.

In many small communities across this country, the only thing they see of the IRS is the handcuff, the enforcement side, the audit, the club. Now their only opportunity to communicate with the IRS is by telephone at a central location 600 miles away.

I would like to change some of that if we can. I think we should take a two-pronged approach if we are ever going to solve this problem with the tax gap and close it substantially. We should do so by providing taxpayer service outreach and by better enforcing our tax laws.

I admit that there has been better matching of information that is given to the IRS, there is better exchange of information with the states, but this is only part of the story. The Service part of the IRS, at least in recent years, has suffered in part by benign neglect and intentional neglect. You have to invest in this side of Govern-

ment if you are going to adequately collect the revenues you expect people to pay for the services which we provide in our Government.

I wanted to make that point to you and just indicate again for the subcommittee that all is not well. We hope all will be well when we finish working together to help the IRS strengthen itself and provide the outreach we think is necessary for the American people.

Mr. Chairman, that is all I wanted to ask the Commissioner, and again, let me say I think you are on the right track. We on this subcommittee can recall not too many months ago the dark days of trying to figure out how we were going to get this mess untangled. I think the chairman also has indicated that it is nice to have a hearing in which we seem to be on the way to untangling a lot of these problems.

Mr. ANTHONY. Would the gentleman yield for one comment?

Mr. DORGAN. I would be happy to yield.

Mr. ANTHONY. The gentleman made a comment to the Commissioner about the growing number of tax shelters. In Tax Notes, April 20, 1987, in response to your offer to settle at 80 and 70 percent, or let the taxpayers pay 20 or 30 percent the following numbers are laid out here.

It says, "the total inventory tax shelter cases undergoing IRS examination have grown over the past several years from about 400 in the early 1970's to over 426,000 in 1986, representing an increase of over 1,000 percent."

I think what Mr. Dorgan says is accurately reflected by the data.

Mr. GIBBS. Mr. Anthony, I would certainly agree. A great concern in tax administration over the last 10 years has been the growth of gimmicks, mail order ministries, family estate trusts, protestor groups, and tax shelters that became increasingly abusive. I do not think there is any doubt about that.

We are delighted, quite honestly, with the provisions that the administration proposed and you gentlemen passed last year that may take a major bite out of the tax advantage of tax shelters. We are seeing less and less in the way of the type of tax shelters that we have traditionally seen in this country over the last 10 years.

The initiative that we proposed is designed to try to move those in a responsible way, but hopefully put this era behind us.

Mr. THOMAS. Just one question in regard to the chart that is in front of me. It was presented to show that you are getting a lot more money for the dollars that we are expending. Why did you choose 1980 as the beginning year and 1988 as the ending year and then use the three odd years—1983, 1985, and 1987—in the center?

Mr. GIBBS. No particular reason, other than the space that we had on the chart. I will be glad to provide you with those other years.

Mr. THOMAS. Why would not the starting year be 1981?

Mr. GIBBS. Pardon me?

Mr. THOMAS. If you are going to show odd years—1987, 1985, 1983—then it would be 1981 rather than 1980.

Mr. GIBBS. Fine, and we will be glad to provide you with those. There is no particular significance to those years.

Mr. THOMAS. Well, there was a rationale for picking 1980 instead of 1981 to put it on the chart, was there not? I mean, it was painted on the chart.

Mr. GIBBS. Well, 1980 was the beginning of this administration.

Mr. THOMAS. I thought the election was in November of 1980 and he was sworn in in January of 1981.

Mr. GIBBS. We simply used that, Mr. Congressman, from the stand point of a base point. You have got to begin somewhere. We chose 1980.

Mr. THOMAS. Again my question is why?

Mr. GIBBS. Because it is the beginning of this decade.

Mr. THOMAS. Okay.

Mr. GIBBS. There was no particular reason. We will give you whatever you would like to have.

Mr. THOMAS. Why would you not take 1982, 1984, 1986, and 1988?

Mr. GIBBS. We could certainly do that.

Mr. THOMAS. Well, you could but you did not. You have no rationale now to present as to why you picked those years? They looked good?

Mr. GIBBS. It is the first year of the 1980's, we are in the decade of the 1980's, and that is what we showed.

Mr. THOMAS. But then you jumped to 1983, 1985, and 1987. You went odd years after that. I mean, there was a rationale for picking those years and presenting them to us on a chart. I would like the rationale for why that chart was drawn the way it was drawn.

Mr. GIBBS. The only way I can explain it, Congressman, is to give you the other years. There is no game playing going on here. We would be glad to give you that information.

Mr. THOMAS. Why do you not do that, because that is a peculiar looking chart if you will examine it. It starts with 1980 and then it goes 1983, 1985, 1987 and then 1988. And interestingly, if you compare 1983, 1985, and 1987 there is not a significant difference in terms of amounts of money expended and returned, but 1980 and 1988 are dramatic on either end of the chart to assist you in terms of the tilt that you were looking for.

Mr. GIBBS. Well, we could certainly do it with 1981.

Mr. THOMAS. I would appreciate the other numbers so I can chart it out myself. Thank you.

Mr. GIBBS. Surely. I would be glad to provide them to you.

[The information follows:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

24 APR 1987

The Honorable William M. Thomas
Committee on Ways and Means
House of Representatives
2402 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Thomas:

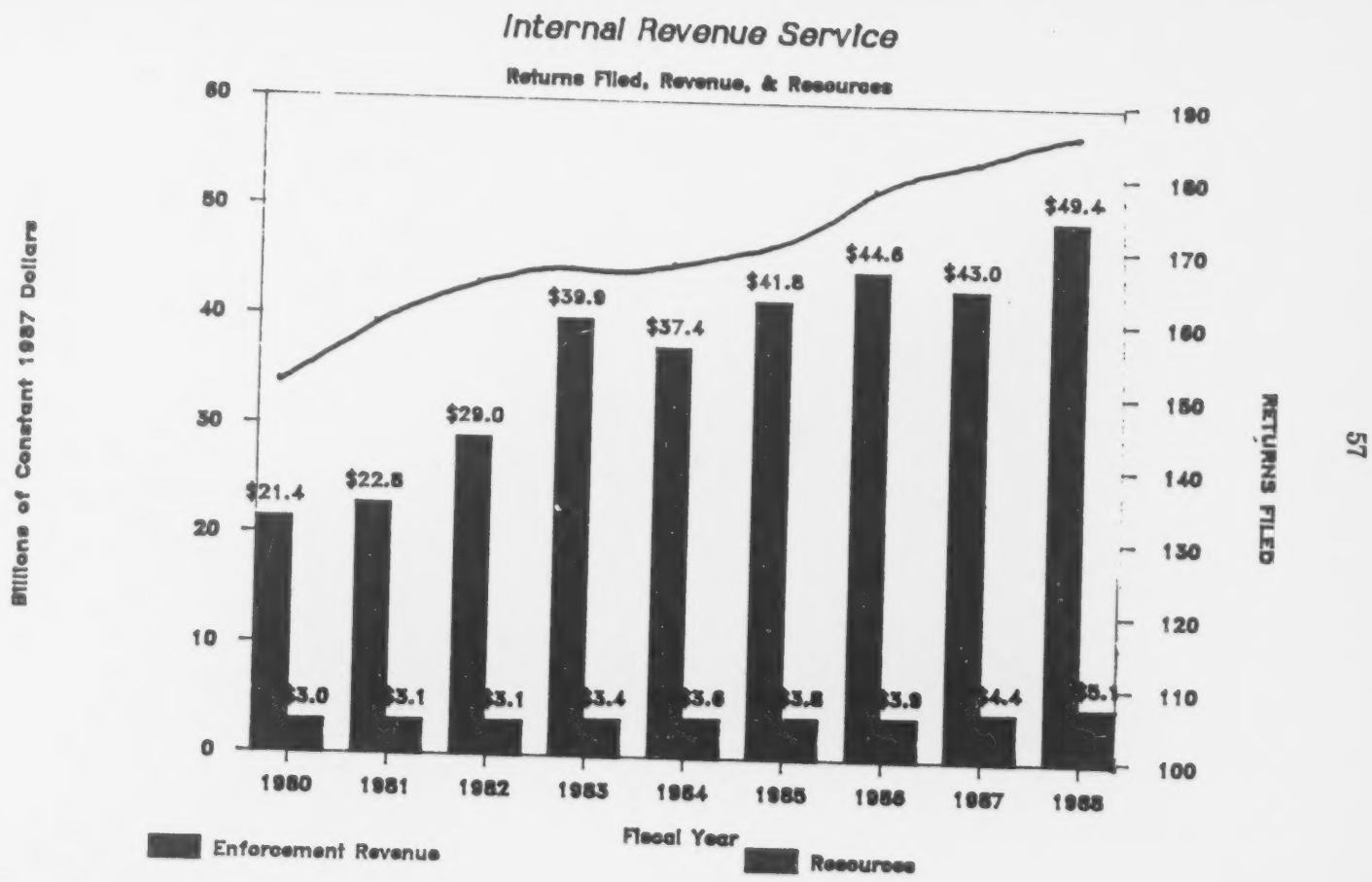
In response to your request of the Commissioner at the Subcommittee on Oversight hearing, I am enclosing a chart which provides budget information for each year, 1980 through 1988.

With best wishes, I am

Sincerely,

Bryan Slone
Assistant to the Commissioner
(Legislative Liaison)

Enclosure


Internal Revenue Service
Returns Filed, Revenue, & Resources
Billions of Constant 1987 Dollars
RETURNS FILED
60
50
40
30
20
10
0
190
180
170
160
150
140
130
120
110
100
$21.4
$22.8
$29.0
$39.9
$37.4
$41.8
$44.6
$43.0
$49.4
$3.0
$3.1
$3.1
$3.4
$3.6
$3.8
$3.9
$4.4
1980
1981
1982
1983
1984
1985
1986
1987
1988
Fiscal Year
Enforcement Revenue
Resources

INTERNAL REVENUE SERVICE
FY 1980 - FY 1986
(Dollars in Billions)

	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988
Returns Filed (Millions)	154.0	159.7	162.8	163.6	164.6	170.0	178.2	181.4	185.7
Revenue from Direct Enforcement (Billions of FY 1987 Constant Dollars)	$21.448	$22.834	$29.020	$39.905	$37.409	$41.849	$44.553	$43.042	$49.388
Resources (Budget Authority in Billions of FY 1987 Constant Dollars)	$3.045	$3.059	$3.126	$3.442	$3.635	$3.814	$3.937	$4.448	$5.071

NOTE: Returns Filed and Amounts for FY 1980 - FY 1986 are actuals.
Returns Filed and Amounts for FY 1987 & FY 1988 are estimates.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

I was back in my district over this last Easter break. I have about eight counties that are oil and gas producing areas. They tell me that since the price of oil has dropped there is no tax being collected from the windfall profits tax, yet they are still required to be part of this 907 million number of information returns that you showed on your chart.

Is there any rational basis, if there is no tax to be collected, to put the taxpayer, to put the IRS, to put the whole system through the problems and the dilemma of collecting that data and that information? Do we gain anything from it or are we at a logical stage where we could suspend it for a period of time?

Mr. GIBBS. Mr. Anthony, I honestly do not know the answer to your question. I think that I have heard some discussion about whether it would be possible under the reporting requirements of the Internal Revenue Code to permit people to defer reporting. It is something that I will be glad to check with the Treasury Department, because I think they are taking a look at it at the present time, and provide you with an answer.

I do not have an answer for you in terms of whether we could do that, or whether the discretion is there to permit us to do it, or whether we would have to have a statutory change if you decided it was appropriate, but I would be glad to find out.

Mr. ANTHONY. I wish you would look into that. I had some sample returns shown to me, and people who are very active in trading in the industry showed me a stack of forms that was a foot and a half high.

They had to mail them and it cost over $50 to mail them, yet there was no tax that was due and owed on that, and it just appears to me that this is also part of where we have a breakdown in our respectability of the Tax Code.

Now, these people did not like to pay the tax to begin with, but they paid it. They griped about it, but at least they paid it.

Now, the griping gets a little bit more harsh when they have got to still file the return on an information basis, yet they know they have no tax due and paid. So if there could be a rational way and still not do any damage I would hope that you could take a look at it and maybe make a report back to the committee as to whether there would be a way that it could be done.

If you do not think it could be done administratively, make a recommendation that if it was the Congress' intent then they would have to do it legislatively, but I would like to know at least where we stand on that.

Mr. GIBBS. All right.

Chairman PICKLE. In that connection may I ask, could relief be granted administratively?

Mr. GIBBS. Mr. Pickle, I honestly do not know the answer to that. I will get an answer and provide it to you.

Chairman PICKLE. Well, let me ask another question then. The windfall profit tax report has to be filled out in all of the offices simply because that is the law. We said you are supposed to make a report, even though you are not collecting any taxes. It was a terrible thing we did in the first place when the Congress passed it.

Now, we are not making any money out of it, it is a losing proposition and it is a burden—would you in the IRS recommend that the Congress then take action to repeal that?

Mr. GIBBS. I would like to study it first. For example, when we say there is no tax being collected, I suspect that there are some people that are paying windfall profit tax even today.

Chairman PICKLE. Well, there would be mighty few.

Mr. GIBBS. It may well be——

Chairman PICKLE. Mighty, might few.

Mr. GIBBS [continuing]. But I do not really have enough information at this point to make a recommendation one way or the other. I will be glad to take a look at it and provide you with the information, though.

Chairman PICKLE. Well, I think something should be done and I would like to have some response from you so the Congress can act accordingly then.

[The information follows:]

ADMINISTRATION POSITION ON WINDFALL PROFIT TAX LAWS

The Internal Revenue Service supports the Administration's position that current Federal windfall profit tax laws be repealed. Repeal of the tax is proposed in the President's Budget for Fiscal Year 1988.

From a fiscal point of view, windfall profit taxes have become a declining source of revenue—we estimate that receipts from the tax since the first quarter of 1986 have fallen to significantly less than $50 million per year. From an administrative point of view, compliance with windfall profit tax laws imposes substantial record-keeping costs on the affected businesses and requires significant monitoring and enforcement costs of the government. From an equity point of view, windfall profit tax laws treat one set of industries differently than others. And, from an economic point of view, windfall profit taxes discourage oil exploration, weakening the prospect of reduced U.S. dependency on foreign petroleum imports and reserves.

The Administration's proposal is consistent with findings in "Energy Security: A Report to the President of the United States." That report, released May 1987, was prepared under the direction of Secretary of Energy John S. Herrington at the President's request and in satisfaction of requirements of Public Law 99-509, the Consolidated Omnibus Budget Reconciliation Act of 1986. Speaking on behalf of the Administration, O. Donaldson Chapoton, Deputy Assistant Treasury Secretary for Tax Policy, and William Martin, Deputy Energy Secretary, provided testimony on this issue before the Energy and Agricultural Taxation Subcommittee of the Senate Committee on Finance on June 5, 1987.

Chairman PICKLE. Go ahead, Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

I have two questions regarding accounts receivable. One, you talk about you have a difficulty absorbing a significant amount of new employees in order to adequately get the job done. First, could you expand more on what the problem is in the absorption, and second, what your definition of the problem is in absorption?

Mr. GIBBS. Yes. It is an issue of our ability to find qualified persons, bring them on, and actually train them and then deploy them from the standpoint of having the management supervision, staff support and so forth. It is a logistical problem in terms of finding the people, recruiting them, training them, having space, facilities, support and so forth available to them within the limits of the fiscal year. That is basically what it is.

Now, again, let me mention that we are pretty well at full absorption in our collection area. In other compliance areas, we do

have the capability to bring on additional employees, but we are pretty well at our absorption point in the collection area.

Mr. ANTHONY. That is what I understood you to say in response to earlier questions. What disturbs me is looking over your accounts receivable inventory, why then would the accounts receivable inventory continue to go up 1983, 1984, 1985, 1986, and projected to go up for 1987 and 1988?

Mr. GIBBS. The principal reason, we believe, after analyzing it, is that the average dollar amount of the accounts receivable is going up and has been going up. When we look at the number of accounts receivable, there is some change in the number—forget dollars for a second, just in the number of accounts receivable, but it is not that significant.

Where the change is occurring is that the average amount of the accounts receivable is increasing. What that means as we begin to assign priorities to collection—and this is also borne out by the numbers—is that our collections are going up. We projected they would go up, but we are ahead right now of where we projected to be for this year. We think that is the principal reason.

Mr. Anthony, we have a study going on in this area to determine why the amount is going up and to more fully be able to answer the question you have asked. But it appears to us at this point that the average amount of the accounts receivable is increasing.

Mr. ANTHONY. But Commissioner, what bothers me, as I understand it that study will not be completed until the Spring of 1988?

Mr. GIBBS. That is correct.

Mr. ANTHONY. You have got two things that—number one, the news media will not pick up the fact that your percent of collections is up. They will skip over that paragraph, but what they will show is that in 1983 the IRS had unpaid accounts. In other words, these are accounts that had been fully adjudicated and everybody knows that they are due and payable.

They are not paid for a multitude of reasons, but it has gone from $24.7 billion to $53 billion projected in 1988. Now, here is where you start hurting yourself, and that is why I think you need to really address this area. You have the average guy who has his taxes withheld. He may or may not get a refund. Then all of a sudden he sees a headline where someone owes the Federal Government in 1986 $47.6 billion.

Well, it makes him mad and all of a sudden he starts saying, why? And then on the next page he reads where you are in the process of trying to settle because you have got a backlog of cases and it may or may not be good management, but you are offering to settle some thousand cases that are either in audit or in appeal and you are going to say, if you will forgive, you will take an 80 percent hit or a 70 percent hit. But what you are saying is that we will be willing to give you 20 percent or 30 percent.

It just appears to me that you start creating, again, an atmosphere for distrust and unreliability. I think this is an area that I would encourage you to really take a look at GAO's study and see if you are accounting for it properly and see if there may be a better way that that breakout could be put in there.

Mr. GIBBS. Mr. Anthony, we are doing that at the present time. I am concerned. I understand the perception issue that you are raising.

When I was here last time, I mentioned that we were concerned that out of the 1985 filing season we had some receivables that really ought to be off the books. We have gone through our highest dollar receivables. The first time we went through we looked at receivables above $10 million. Then we looked at receivables above $1 million, and finally we looked at receivables above $100,000.

We have gone through and identified bad receivables with that kind of a review. Having done that, we also have found that there are several things in our receivables that we need to take a closer look at.

For example, when employment taxes are assessed and not paid by the corporation, you oftentimes will assess them as a penalty against responsible officers. Therefore, you may have the same amount assessed against more than one person. We have been recording all of the assessments. For example, if we propose the one penalty amount against three people then we have three times the receivables, but we can only collect the amount of the original penalty.

Now, beyond going through and cleaning up, as it were, our receivables—and that will be done fairly promptly—we also find that we need to explain our receivables better. For example, we carry receivables as a tax administrator that other businesses probably would not. They would consider them to be uncollectible. The reason we carry them is because while they may be uncollectible now, the person may well have a refund in several years that we can offset to collect the receivable. So we carry our receivables a lot longer than most commercial enterprises would.

That distorts to some extent the dollar amount of our receivables. We think it is good administrative practice, but to be honest with you it gives a view of what our receivables are that most businesses would consider to be somewhat inaccurate. We need to find ways to articulate this and present it in a way so that we and the public understand what our receivable picture really is, and that is what we are trying to do.

Mr. ANTHONY. Well, I applaud you in that statement and I encourage you to work as quickly as possible because I think this would help people in the field that are trying to defend the IRS in the ability and the job that you are trying to do. Personally, I am pleased with what you have done since you have been appointed and since you have taken over.

The fact that you have gone up against OMB and asked for more money and the fact that you have even convinced them to give you more money tells me that a whole lot of people understand that there has been a changed set of circumstances.

You recognize that before you came on board that Chairman Pickle had to almost force some supplemental money into the system because the record was very clear that there were some problems out there.

Your attitude is refreshing and I want to tell you as one member of the subcommittee I applaud your efforts and I want to encourage you to keep them up, but in these areas where we think we still

have some serious problems I hope you can give us some data. I really look forward at an early moment to get some information on this windfall profits tax.

Mr. GIBBS. Mr. Anthony, thank you. I welcome, and we welcome your oversight.

Mr. ANTHONY. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Chairman, I first would ask unanimous consent that my opening statement be placed in the record at the appropriate place.

Chairman PICKLE. Without objection.

Mr. SCHULZE. I would like to compliment you, Larry, on the job that you have done. You have been accessible. I think that you knew when you took the position that it is a potentially volatile job but you have handled it with dignity and aplomb. I congratulate you.

I am concerned that most of the additional money is going into enforcement and compliance. As I look ahead and see the implementation of the new tax law I find numerous questions. You cannot pick up a weekly newspaper without reading some kind of a column on the new tax law, or a reference to the tax law. Or a report on what is going to happen or what might happen.

It seems to me that you are going to have to upgrade taxpayer services, especially in the next year. I am saying this even if compliance has to suffer somewhat. I believe it is going to be vital.

Now, I said a minute ago that you recognized the volatility of the job. I see a potential volcano next year if we do not have sufficient taxpayer service. There are going to be numerous questions as I am sure you are aware. But I am concerned at this point in time in your stressing enforcement and compliance over taxpayer service.

Would you care to comment on that?

Mr. GIBBS. Yes, I would, Mr. Schulze. I share your anxiety and quite honestly it is also shared by the administration. That is the reason for requesting the 5 percent transfer authority, if necessary. As I mentioned a minute ago, one of the things that we are dealing with here, as we come out of 1985, is the uncertainty of what we are facing.

Remember that in taxpayer service, two-thirds of our inquiries each year deal with taxpayers' accounts. Those inquiries, frankly, are going down fairly substantially as we address the unpostables, the adjustments and so forth. We are finding, for example, that if you were to exclude the questions that we received this year about our W-4 form, we would be substantially under what we had projected would be the volume of calls that we would receive this year.

As it is, we are somewhat over, but not drastically over, what we had projected. We really do not know what we are going to face, which is why we need that 5 percent transfer ability. I would like to underline that it is an ability to transfer away from compliance activities, if we need it, up to about $70 million, plus another $30 million within the appropriation itself. So it is a significant sum that provides us with the flexibility to address the concerns that may arise as we go through tax reform implementation.

Mr. SCHULZE. Okay. Larry, I hear what you are saying and I hope that you plan to shift most of it because I think you are going to have to. I really do.

You are going to have the first filing season under the new law about the same time the primaries occur in many States. What I am saying to you is that I see a lot of confusion. The local politicians, the House Members and the Senators are going to get phone calls about this and it is going to be at a sensitive time when they are concerned about their primary races and it is a warm time politically.

I believe the burners are going to be turned up under your position next Spring. I would strongly urge you to have those contingency plans. You know, if I were in your shoes what I am saying is that I would not have them as a contingency. If I were going to err, I would err on the side of assisting the taxpayers and doing everything in my power to make sure that the filing season goes well.

Well, enough said.

Mr. GIBBS. Mr. Schulze, thank you. I appreciate that. You know, one of the things that you all have been very, very good about, as I have testified, is to ask me from time to time, "Larry, how can we help, what can we do, Commissioner?"

Support of the 5 percent transfer authority this year would be an extremely helpful thing. I will certainly do it responsibly. I will certainly keep everyone up here informed in terms of what we are doing. But as some of the recent publications in this area have pointed out, the ability to have that kind of flexibility is important and I would urge that you seriously consider providing me with that capability as we go into this next filing season.

Mr. SCHULZE. Larry, I do not like "what if" questions but I am going to ask you one.

If the tests of the new front-end processor computer system fail again this summer, then how much wider do you see the gap becoming between the older processors and their replacements? I hope that does not happen, but I am asking you what if?

Mr. GIBBS. Frankly, we are looking at all eventualities in that regard. We had a pretty good filing season this year; very good from the standpoint of the performance of the front-end processors. We have done one thing recently; we have taken one of the ones that we had in reserve and have moved it into a center while we are refurbishing the one that we have. We are really anticipating that this is something that we might do to be ready for the filing season next year.

The performance has been good so far. We obviously would prefer not to have to depend on the front-end processors that we have but we are already taking steps and taking a look at alternatives in terms of if we have to, can we find some additional ones on the market and can we begin to change them?

Mr. SCHULZE. That still gives us two for a back-up, though.

Mr. GIBBS. It does and for that reason we are looking to see if we can find some additional ones. If not, then we can actually change some of the ones we have that are operating, change them for the two that we have left, and in effect use those to update the ones that we have.

Mr. SCHULZE. Well, I am glad you are thinking of it. I hope it does not happen, but I am glad that you are at least looking at contingencies.

Now, Larry, last week I wrote to you regarding your CP-2000 notice and the automatic insertion of presumptive negligence penalties. Are you planning to change the wording or explanation in the CP-2000 form?

Mr. GIBBS. We have underway at the present time a study to look at the presumptive negligence penalties. I wrote the Congress—the tax writing committees—a number of months ago about the fact that we were going to be imposing these penalties, which have been in the law now for several years. We have sent notices out over the years indicating that we were not going to impose them, even though we were supposed to do it, in order to let people get their records in order and so forth.

Frankly, we have been criticized for that. So we have moved forward, and we are getting some comments and some concerns. We do have a study underway to take a look at that area and particularly the notice and its explanation area.

One of the things we are looking at, Mr. Schulze, is to see whether perhaps we ought to have some sort of tolerance there, so we do not have extremely low penalties that are being imposed. In some situations where people pay the tax and leave the penalties owing, we need to have some way to dispose of those penalties short of asking people to go to litigation. We recognize that and we are trying to address it.

Mr. SCHULZE. Good. Independent contractors. Can you look in your crystal ball and tell me whether we are going to be able to assuage some of their concerns, and when?

Mr. GIBBS. Mr. Schulze, this is one where I guess I would draw on Yogi Berra to say "It is deja vu all over again for me. When I was here 10 years ago as the Assistant Commissioner (Technical), I had to deal with the difficulties of attempting to apply the only test that we have in the Internal Revenue Service to determine whether someone is an employee or independent contractor, and that is the common law test.

It is not a satisfactory test. It was not then, it is not now, and it is not going to be. It is a difficult test to apply. I used to say that when I read employment tax rulings, as they came across my desk they were like O'Henry short stories. I would read the facts, I would read the law, and then I would have to look down to see: Is the person an employee? Is the person an independent contractor? It is not a satisfactory area.

That is the reason for the moratorium that was imposed in 1978. When Congress has acted in the past, what they have usually done when they have taken a group out of the protection of the moratorium is to provide more precise rules, such as with direct salesmen, in the real estate salesmen and so forth. That was not done here.

What we have done is put the people back into the status of being subject to the common law test, which was the reason we had the moratorium in the first place. We are working to try to come up with some guidelines, with some regulations and with some rulings to bring some clarity to the area.

If you want my personal opinion, it is that the common law test is a very difficult one for taxpayers to understand and for us to administer. That is why we had the moratorium to begin with.

Mr. SCHULZE. If you have some suggestions on how we can be helpful, then we would be happy to have them. It is one that is going to be difficult, as well as the next issue that comes to my mind, the taxable year provision. Do you have any suggestions on a way that we can phase into it? I know that you probably are hearing from the accountants as much as we are concerning the massive problems they foresee.

Do you have any thoughts on a way to ease that potential problem?

Mr. GIBBS. No sir, I do not, not at the present time. I know that it is under study at the Treasury Department. We have folks from the Service and the Chief Counsel's Office who are participating in the study, but I do not have suggestions to offer at the present time.

One of the questions that has been raised there was also raised here the last time I was here: what kind of an impact is this going to have on the Internal Revenue Service and on the filing season next year? We really do not know. We honestly do not know the answer to that—whether people will file for extensions or whether they will give us the additional returns. We simply do not know at this point.

Mr. SCHULZE. I am sure the chairman would be happy to sit down with you and discuss if there is some way we could just ease this transition, even for a 1- or 2-year period. I see a potential problem here, and maybe there is something we should do ahead of time to ease it.

Larry, I want to commend you for going a long way to alleviate the concern of our nonprofit sector regarding the proposed regulations on lobbying by tax exempt organizations. I hope that we are able to work that one out. It looks like we are heading in that direction.

Now, I understand you are aware of legislation I have introduced, along with many of my colleagues on Ways and Means, to correct what I view as a horrible error in our tax laws affecting innocent spouses. I wonder if you can give me your views on that. Quite frankly, I would like to know whether I am going to get support from the IRS on that legislation and whether we should look forward to a peaceful or a stormy voyage on that innocent spouse corrective legislation.

Mr. GIBBS. Mr. Schulze, I think I will really defer to the tax policy staff at Treasury on that, and not intrude in their domain with respect to tax policy. I would be delighted to sit down with them and with you, but I really think it would be better to permit the tax policy people at Treasury to be part of the response, or to make the response if they would prefer.

Mr. SCHULZE. I am scheduled to have lunch with Jim Baker. You have given me the opening that I needed.

I have other questions but in the interest of time I will defer those until a later time. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Schulze.

Commissioner, I know that you need to leave for another appointment, but I appreciate the fact that you could stay over. I want to ask a few questions and then we are going to have the GAO testify.

I hope you can stay and respond after that to any of the comments that GAO may make or that we may make. I hope you have time for that.

Mr. GIBBS. I will, Mr. Chairman.

Chairman PICKLE. Now, in the meantime let me ask a few questions that we have been asking ourselves here at the committee studying what you have said, studying what the GAO has reported to us, and making our analysis.

In the first place, let me say to you that concerning the accounts receivable, I think it is alarming that we have gone from $24 billion in 1983 to almost a double figure now in 1987-88, even more than that. I do not think it is dollar volume alone. The percentage just keeps going up.

I understand you want to keep some on the books, but I think we need a more detailed analysis from you, from IRS, of what is causing the increase, because we cannot just let accounts receivable keep going up without attacking it or trying to address it some way. So would you give me a further analysis about whether it is the economy, whether it is installment figures, whether it is just more returns, or whatever it may be.

Mr. GIBBS. We are looking at that right now, and the only thing that I can say—and this is not a complete answer, but it is the one bright spot—is that as the receivables have gone up our collections have gone up as well. Now, I realize that means we still have to address the reasons for the inventory and so forth. But our collections have more than tripled during the period that we are talking about.

[The following was subsequently received:]

IRS accounts receivable inventory as of March 31, 1987

	Millions
Notices	$10,984
Taxpayer delinquent accounts	12,734
Installment agreements	874
Currently not collectible	10,218
Deferred	416
Other systems monitored	7,995
Total delinquent	43,221
Non delinquent and current	5,215
Total accounts receivable	48,436

Chairman PICKLE. I understand they have gone up. I also understand the compliance rate is going down and these are conflicting currents and we need to make a deeper analysis of it.

Now, on audit coverage, in 1980 we had over 2 percent audited. In 1988 you are asking for money to give us only about 1.6 percent coverage, going up in the next two or three years to about a 2 percent level. Now, on the surface that looks like a mighty small figure.

Help me break it down. What is the individual examination level? For the individual, what will that be? Of the 1.6 percent,

what is the individual examination rate as compared to the corporate examination rate?

Mr. GIBBS. Mr. Pickle, we can provide you with that information—the 1.6 percent, you are right, does combine individual and corporate coverage levels projected for fiscal year 1988, and we can provide that.

Chairman PICKLE. I want to find out how much is being audited with respect to the individuals, how much with respect to the corporations, and then I want to ask, can we possibly pick that amount up? That means out of how many millions of returns? Of 180 million returns are we going to audit only that percentage?

That is going to encourage a lot of people to just say well I will not get caught. So, it seems to me like we have to put greater emphasis on this audit percentage than we are. If it was twice as much, that means that when IRS was here 10 years ago it must have been 3 percent then, or more. So it has been going down, down, down and we must pick that up.

Do you have any comment about that?

Mr. GIBBS. I can give you the audit coverages for individuals and corporations, so let me go back and give that to you for the record. The audit coverage we anticipate for 1988 for individuals will be 1.32 percent and for corporations, 2.35 percent.

Chairman PICKLE. It was 1.32, and what is the other?

Mr. GIBBS. It was 1.61 percent overall; 1.32 percent for individuals, 2.35 percent for corporations.

Chairman PICKLE. Well then 90 percent of it, almost, is going into individuals rather than corporations. Are you satisfied with that?

Mr. GIBBS. No sir, I am not. I am not satisfied with it. I am pleased that we are getting the resources to permit us to turn the downward trend around and head it up.

Chairman PICKLE. All right. Now, with respect to taxpayer services and with respect to the staffing levels, we have analyzed the budget and we have analyzed what the GAO has given to us. It looks like the overall number of positions for taxpayer services for 1988 will decrease from 1987 levels, a decline of about 191 positions. You requested 1,698 more taxpayer service positions than included in OMB's budget submission.

Now, do you agree with those figures? We show and GAO shows that you actually are requesting 191 less positions.

Mr. GIBBS. Well, I believe that 191 number includes the figures on the reprogramming, the transfer of 500 staff-years that I did this year. If you look at it without the transfer of resources that we put in it this year.

Chairman PICKLE. No. The transfer has to be a factor. You transferred some 500 people into it.

Mr. GIBBS. Yes. As I indicated, I also have the discretion to transfer up to—what we have asked for—up to 5 percent additional.

Chairman PICKLE. I understand that, but it also concerns me that someone else this morning or you had recommended very strongly that we increase this interdepartment transfer authority up to 5 percent. That is not very much of an increase from what it is now. You transferred these 500 or more this last year and that affects the level of services.

Now, that might have helped wherever you transferred to in taxpayer services, but that means other departments are going to have to suffer for that. You cannot transfer 500 people over without causing a breakdown in other categories, or at least a possible breakdown; is that not correct?

Mr. GIBBS. We have tried to minimize the impact this year by taking it from things like furniture, travel—support-type of categories—so that we did not impact on the other established functions. Sure, there is always an impact when you transfer funds. There is no doubt about it. We simply tried to minimize that impact.

Chairman PICKLE. It seems to me that if you want to have the authority to transfer amounts, you would just be trying to use limited staff for multiple purposes instead of just asking for more staffing directly in different categories?

Mr. GIBBS. Mr. Pickle, that is what I tried to explain. Let me approach this from the standpoint of what we had in taxpayer service as we came off the 1985 filing season.

We really beefed up the taxpayer service in 1986, and the reason we did that was because we knew that we were going to have to deal with the adjustments and the unpostables and all of the things that came out of the 1985 filing season. As we went from 1986 into 1987, one of the questions was—since two-thirds of our taxpayer service is account related—what were we going to be able to do with respect to the inventories that I mentioned a minute ago? Well, they have come down dramatically.

Now, do we still need the same level in taxpayer service with the decrease in our account related work. We have got tax reform going the other way, which suggests, that as you all have pointed out, and I think quite rightly so, that we may have a very big need for 1988?. We have things that we really do not know at this point, in terms of what the level of need is going to be and that is why the administration has proposed the 5 percent transfer authority.

Chairman PICKLE. Well, I can understand why you would want that increase and I can understand why that is important, but we are also concerned about what department will suffer if that does come about. Otherwise, you could just come to us and say, we want $10 billion to run our agencies, thank you very much and you would not give us any breakdown. I do not think the Congress is going to accept that.

So, while you want more authority I think we have got to also balance it. I would ask you a broad question. How many positions does IRS need in taxpayer services?

Mr. GIBBS. How many positions?

Chairman PICKLE. How many positions do you really need to adequately take care of taxpayer services?

Mr. GIBBS. That is what we are sorting through at the present time. As we come out of the filing season, and as our inventories of account-related work have gone down, as tax reform starts to heat up with the implementation of it, what are we going to need in taxpayer service? We are in the process of attempting to determine that at the present time, Mr. Pickle.

Chairman PICKLE. Well, that gets to be a fundamental question. What do you need and what did you request? You requested a lot more than you got and now you are saying what you got is just

fine. But, I guess you have to justify what you do have, what you end up with, and be as happy as you can about it.

What we want to know is what do you need? You ought to be just as bold with us as you can be.

Mr. GIBBS. That is what we are trying to determine at the present time, with the conflicting factors that I have mentioned.

Chairman PICKLE. Well, let me look at the toll-free telephone services. You estimated that a 65 percent level of service would be satisfactory in 1988, and yet you also admit that what is optimum—what you should have—would be 85 percent. Now, how can you be satisfied with the 65 percent level?

Mr. GIBBS. I do not believe we would be satisfied with a 65 percent level. As I indicated, one of the difficulties is that in the preparation of the budget, which takes place a year to two years in advance of the actual fiscal year period, you are making estimates as to what you think those call levels will be. For example, this year, as I mentioned, we had made an estimate of what we thought we the call volumes were going to be. But for the W-4 issue, they would have been substantially below what we had projected for this year.

Now, this is why—as we move closer to the filing season next year and as we see what happens in the remainder of this year—we will be taking a hard look at that, and as we get closer to it I am not going to be satisfied with a 65 percent level. And, indeed, that is a discussion that I have already had within the administration and the reason for the 5 percent flexibility if we need it.

Chairman PICKLE. Well, we have got to shoot for that 85 percent and we have to get there just as quick as we can and not be satisfied with the 65.

Now GAO tells us that the Internal Revenue Service often does not accurately or completely answer taxpayers' telephone inquiries. They report to us that they found in 1987 the IRS was incorrect in its responses 22 percent of the time, incomplete 15 percent, and correct only 63 percent.

Is that agreeable to you, or do you contest that, and what steps are you taking to change that?

Mr. GIBBS. I have said before that I am concerned and not satisfied over the figures themselves. I have also said that I think it is important that we place those figures in context. As I indicated, we think that, based on our projections, we will receive somewhere around 60 million-plus calls next year. Now, two-thirds of those calls, Mr. Pickle, will relate to account related items.

The GAO study did not deal with account related items in any way. They dealt only with tax law questions, and the tax law questions were based on 21 questions that the GAO submitted. There were three questions that pulled the average down—three out of the 21—and two of those three dealt with issues that we have not previously dealt with in taxpayer service in prior years.

One was on the Tax Reform Act, obviously. The other was on the W-4 where we had not had the W-4 inquiries.

Chairman PICKLE. Those two—the Tax Reform Act and the W-4—represented what percentage of overall calls?

Mr. GIBBS. My recollection—and the GAO folks can correct me on this—is that if you excluded those three questions—three of the

21 where we did poorly—that our performance was up substantially over where it was in terms of the 1960's and the 1970's, into the 1980's, as I recall, and more in line with what we have traditionally done.

Chairman PICKLE. Well I would hope, and I know you would, that we get seasoned experienced people in the taxpayer services area who are familiar with the calls and know how to answer and give more accurate responses. I think it is tremendously important that we have good taxpayer services and we ought to put more money into it instead of less.

It is one thing to emphasize compliance. It is another thing to also give taxpayer service. I personally think it is one of the most positive things we can do. I do not think anybody would disagree if we have the resources to do it.

Mr. GIBBS. Mr. Pickle, I agree with you. I would also like to mention that we do have substantial additional training activities planned in taxpayer service for our taxpayer assistors this year.

Chairman PICKLE. That is good. Well, why is it that as we have put on more people, we have increased the taxpayer services and we are trying to change our image that we find more and more people are filing late this year. Why is that?

Mr. GIBBS. I do not know. It has been suggested to me that there are perhaps several explanations. One is that some people are waiting on information return that come to them so they can prepare their individual returns—forms from partnerships or trusts, things of that nature.

Chairman PICKLE. Well, why would that be any different though than last year or the year before?

Mr. GIBBS. Actually it is not. The trend over the last several years is that the peak of the filing season has been occuring later and later and later, and that is a trend, really, that is fairly consistent over the last several years.

Chairman PICKLE. Well, is it the economy?

Mr. GIBBS. Again, I do not know. I know that we do not know for sure. I do not know that anyone does. It has been suggested in other places that people are simply waiting longer—procrastinating—to file their returns. One of the things that was a surprise to me was that we had a number of refund returns that were filed late. Why someone waiting for a refund is not filing earlier, I do not know, but that is occurring.

Chairman PICKLE. Well, I do not guess we know either, but it is significant that we are better prepared to handle them and yet they come in slower.

Mr. GIBBS. We were not only better prepared to handle them, we did handle them and did turn the refunds around faster this year than we have in memory.

Chairman PICKLE. Will there be less returns filed this year than last year, or don't you know yet?

Mr. GIBBS. We are still in the process of counting the returns that are coming in. We are processing them at the present time. I will have that information for you in several weeks. We will see what the extensions look like and what the returns filed look like.

[The following was subsequently received:]

INDIVIDUAL INCOME TAX RETURNS—MAY 29, 1987

[In thousands]

	1986	1987	Change
Receipts to date	96,947	98,367	1,420
Extensions F4868[1]	4,649	5,022	373
Total to date	101,596	103,389	1,793
Receipts for year (1986 actual) (1987 projected)	102,232	104,004	1,772
Percent to date	99.38	99.41	.03

[1] Extensions are through June 22

Through May 29, 1987 the IRS has received 98.4 million returns, 1.5 percent more than the 96.9 million received this time last year. We have also received 5.0 million extensions of time to file, .4 million more than last year.

The number of returns plus extensions received so far in 1987 is 103.4 million compared to 101.6 million last year, an increase of 1.8 percent.

We expect to receive a total of 104.0 million returns through the end of 1987, 1.7 percent more than the 102.2 million received in all of 1986.

Chairman PICKLE. I am glad to see the improvement in the correspondence and adjustments inventory. It is going down and that is encouraging.

I want to ask you one other question, and I know we must go on and I will not delay this. But I want to get another statement from you on the IRS computer operation. The front-end processors are still getting older and older and we have got only a period of two or three years to get the new ones on line now, and at least we know by 1991, 1992.

Now, regarding the new front-end processors, are they available and on hand? Do we have the new front-end processors available? Are they at the Service Centers?

Mr. GIBBS. No. Actually, once we complete the test with Sysorex we are talking about——

Chairman PICKLE. Is there any problem in obtaining them once we complete the test and we know it can operate?

Mr. GIBBS. No. And let me ask, if I could, Mr. Coleman to comment on that for you, because he can give you a little more information than I can on it.

Chairman PICKLE. All right.

Mr. GIBBS. Tom?

Mr. COLEMAN. Mr. Pickle, the actual hardware is not in the centers yet, but the front-end processors is a standard IBM-4381, and is not a unique piece of equipment.

Chairman PICKLE. So you anticipate no difficulty in getting the machines once it is shown that your software is applicable and workable?

Mr. COLEMAN. That is right, sir. Delivery schedules are all set up and we are ready to go.

Chairman PICKLE. All right. Now, we have already lost a year-plus going from the old to the new processors, and it is not a very good record, the squabbles and arguments and the accusations about who was wrong or who was at fault.

But if I understand you, you are saying that your preliminary tests seem to show that the software programming has been arranged and will be workable at the speed and the level you want.

But, you are going to have another testing in June. What? June 1? June 15?

Mr. GIBBS. June 15.

Chairman PICKLE. Well, we will want then again a full report from you. I want to know if the disputes have been settled and are we able to go forward, if it is workable, and then the question is at that point will you then order your front-end processors?

Mr. GIBBS. As Mr. Coleman indicated, we already have the orders in place, from the standpoint of having it set up to bring them on line.

Chairman PICKLE. How long will it take you then to get them?

Mr. GIBBS. If we stay on schedule, we are anticipating that our three largest centers will have them before the fling season next year.

Chairman PICKLE. Eighty-eight?

Mr. GIBBS. Yes.

Mr. COLEMAN. If the test in June is successful the first installation will be in Fresno, California and we expect that in July.

Chairman PICKLE. All right.

Now, suppose if does not work? Suppose the test does not pass? Then where are we? We have lost, in effect then, 2 years. And we are getting perilously close to the point where we have just got to have action.

Are you confident that it will be satisfactory?

Mr. GIBBS. Mr. Pickle, we took a look at this last fall, and we took a look at what our alternatives are in this area.

One alternative was to use what we have, which we know is getting older. Maintenance will eventually be a problem. The second alternative was to go back to the competitive bidding process. If we do that, we are looking at probably another two years. And the third alternative was to stay with the Sysorex folks and make the demands that we are currently making, to stay on top of them from the standpoint of monitoring what they are doing, and find a way to make the system work. Those are the alternatives that we have been presented.

Chairman PICKLE. Well, it just seems to me that you better hope and pray that these tests work out satisfactory in June. If it does not there is a possibility that all hell is going to break loose and it is going to send fright waves all across the country. So lets just withhold judgment until June and see how that test works out.

Mr. GIBBS. Well, all right. But I would like to not leave on that comment for this reason, Mr. Pickle. I do think it is important to recognize that from the standpoint of the way the testing is going it does appear that we have turned the corner.

Second, if we were in the position where we had to continue to rely for a period of time on the front-end processors that we have, they have performed very well through the current filing season and we have not had any major problems with them.

So from the standpoint of people believing that we would have real problems, either later this year or even on into the next year's filing season, I do not think that is quite accurate.

Chairman PICKLE. All right. In light of the fact that your computer budget this next year is about $850 million, I ask you to submit to the subcommittee an analysis of our anticipated budget-

ary requirements for each major ADP project with the fiscal year 1988 expenditures of $10 million or more.

In other words, I want to know what is your budgetary requirement for the next few years, based on the fact that we will move forward on it.

Mr. GIBBS. Fine, Mr. Chairman. I will be glad to provide you with that information.

[The information follows:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

Major Information Technology Acquisition Plans
1987 - 1992
($000)

Internal Revenue Service

Item: COUNSEL/APPEALS TRACKING SYSTEM CC-05

Obligations:	1987	1988	1989	1990	1991	1992
	2213	3000	11283	10021	9516	9618

Description: An interactive case tracking and legal research system, designed to provide management information and statistical data.

Item: AUTOMATION PROJ.-OFFICE OF CHIEF COUNSEL CC-15

Obligations:	1987	1988	1989	1990	1991	1992
	591	219	3731	2625	3763	1881

Description: A composite of various management information systems, word processing, electronic research, and electronic mail systems.

Item: COMPUTER SERVICES OFFICE AUTOMATION DC-06

Obligations:	1987	1988	1989	1990	1991	1992
	433	433	7943	2644	2797	2959

Description: Provide automated systems to increase efficiency through ADP technology in support of analytical, managerial, communication and information sharing tasks.

Item: ADP SUPPORT/APPLIED RESEARCH/COMM. STUDIES DC-07

Obligations:	1987	1988	1989	1990	1991	1992
	1937	1937	9311	9690	9852	9963

Description: Provides a readily available, cost effective means for the Service to meet demands for ADP support in lieu of staffing increases.

Item: TAX PROCESSING PRINT SYSTEMS DC-09

Obligations:	1987	1988	1989	1990	1991	1992
	9485	12000	13524	12740	11428	11902

Description: Provide printing capacity necessary for printing and issuing notices to taxpayers and other essential compliance documents and forms.

Item: IDRS-DCPS/TERM REPLACE AND PRINT/MICROFILM DC-10

Obligations:	1987	1988	1989	1990	1991	1992
	32588	39000	50337	48169	29929	29334

Description: Provide terminals and supporting equipment, including communication processors, by which taxpayer account information may be accessed by IRS compliance, enforcement and Taxpayer Service personnel.

Item: LOCAL AUTOMATION-MAINTENANCE DC-14

Obligations:	1987	1988	1989	1990	1991	1992
	7715	985	33404	18635	18635	18635

Description: Provide maintenance for existing installed equipment supporting local automated systems.

Item: SERVICE CTR REPLACEMENT SYS./SC UPGRADE DC-16

Obligations:	1987	1988	1989	1990	1991	1992
	37294	42005	37529	31233	28730	30716

Description: Provide lease and maintenance of main tax processing system in service centers. Also provides for expansion to meet needed capacity requirements.

Item: MULTIPURPOSE MICROCOMPUTERS/SOFTWARE DEV. DC-35

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	1799	1668	2270	2090

Description: Acquisition of multi-purpose microcomputers will optimize the utilizations of scarce technical resources by providing a more efficient and effective tool to perform program coding, compiling, testing, and documentation functions.

Item: NCC INTERACTIVE PROGRAMMING/RJE SYSTEM DR-01

Obligations:	1987	1988	1989	1990	1991	1992
	2092	2308	2127	289	289	289

Description: Replaces obsolete computer system used for remote job entry by programmers doing master file program development. System is also available to process master file production workload when not being used for program development.

Item: DISTRIBUTED INPUT SYSTEM DR-04

Obligations:	1987	1988	1989	1990	1991	1992
	0	23698	19496	10810	9360	9951

Description: Replaces the outdated Direct Data Entry System with a system utilizing mini-computers, each supporting 24 distributed data entry terminals.

Item: MASTER FILE PRODUCTION SYSTEM DR-08

Obligations:	1987	1988	1989	1990	1991	1992
	1409	1143	1111	1133	1224	1322

Description: Master file operations include establishment, maintenance and updating of individual, business, exempt organization, employee plans, individual retirement accounts and information returns master files.

Item: AUTOMATED TECHNICAL & REFUND INQUIRY SYSTEM DR-11

Obligations:	1987	1988	1989	1990	1991	1992
	6201	7323	7921	8574	9287	10066

Description: Provide automated technical tax law and refund inquiry information by converting digitized speech stored on disk to analog speech. Both touch-tone and dial phones can access information.

Item: OCR - FEDERAL TAX DEPOSITS DR-16

Obligations:	1987	1988	1989	1990	1991	1992
	3005	2785	3418	3844	0	0

Description: Processes Federal Tax Deposits by utilizing OCR technology to read and microfilm FTD documents, and to identify certain type of errors.

Item: REMITTANCE PROCESSING SYSTEM REPLACEMENT DR-19

Obligations:	1987	1988	1989	1990	1991	1992
	824	3008	6736	6793	6870	6093

Description: Replacement of old remittance processing system equipment.

Item: REMITTANCE PROCESSING SYSTEM-BASELINE DR-20

Obligations:	1987	1988	1989	1990	1991	1992
	4834	4834	4022	0	0	0

Description: Utilize automation to endorse, sort, stack, and balance remittances and to create an audit trail of RPS activities.

Item: SERVICE CENTER INTEGRATED MANAGEMENT SYS. DR-27

Obligations:	1987	1988	1989	1990	1991	1992
	1002	2500	2726	1812	1811	1582

Description: Provides for a new Integrated Management System (replacing IMFIS) and development of a cost accounting reporting system in the service centers. IMS will provide real time on-line replacement for the current work planning and control system.

Item: SYS. FOR CONTROLLING ASSESSMENTS/NOTICES DR-31

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	2564	1952	1883	1877

Description: Automates the entire Non-Master File (NMF) billing and posting tax system. The computers will be connected by telecommunications to a centralized directory for transfer of accounts and credits and transmission of account transcripts.

Item: TAXPAYER SERVICE ADVANCED WORK STATION DR-34

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	11752	19848	13866	13638

Description: Implement network of desktop microprocessors, referred to as advanced work stations, for use by assisters in toll-free sites and possibly walk-in sites.

Item: MODERNIZATION OF NCC'S MAGNETIC MEDIA DR-37

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	1663	3648	3648	629

Description: To obtain tape cartridge subsystems to replace some existing old tape drives and acquisition of high-density disk drives in sufficient numbers to permit migrating certain read-only files to disk storage.

Item: FORM 1040 OPTICAL CHAR.RECOGNITION (OCR) DR-38

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	3782	17189	18370	18605

Description: Automation of front-end processing of paper by using OCR data conversion to provide a return image to be linked to FAISR, and convert taxpayer figures to a machine readable language to pass through the existing Generalized Main Frame processes.

Item: FULL UTILIZATION OF ELECTRONIC FILING SYS. DT-03

Obligations:	1987	1988	1989	1990	1991	1992
	0	7604	5738	5640	4753	4753

Description: Provides for automated receiving, sorting, blocking, numbering, coding and editing, and transcribing of returns filed electronically by automated return preparers.

Item: TAX SYSTEM REDESIGN (PHASE I, II, III) DT-04

Obligations:	1987	1988	1989	1990	1991	1992
	6156	6856	32122	75918	440848	468076

Description: Provides for the movement of service center real time processing (IDRS), decentralized master file operations, and automated return processing functions to new computer facilities.

Item: FILES ARCHIVAL IMAGE STORAGE AND RETRIEVAL DT-05

Obligations:	1987	1988	1989	1990	1991	1992
	1125	3004	8634	34751	36823	18994

Description: Study the feasibility of using digital optical technology for storage and retrieval of tax return images.

Item: AUTOMATED COLLECTION SYSTEM OPC-01

Obligations:	1987	1988	1989	1990	1991	1992
	74162	65856	62912	63098	63525	62015

Description: Applies state-of-the-art computer and telephone technology to the processing of delinquent accounts and returns.

Item: INTEGRATED COLLECTION SYSTEM OPC-05

Obligations:	1987	1988	1989	1990	1991	1992
	6943	25000	55473	55522	41159	16855

Description: Fully automate the Collection Field Function, Service Center Collection Branch and Special Procedures function with communication or interface with IDRS/SCRS and ACS.

Item: AUTOMATION OF CRIMINAL INVESTIGATION OPCI-01

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	8544	12605	11205	9780

Description: Use ADP technology to modernize case processing and information gathering and to provide electronic mail capability.

Item: CRIM. INV. NTNWIDE RADIO SYS. REPLACE. OPCI-04

Obligations:	1987	1988	1989	1990	1991	1992
	0	0	6756	4267	3788	2433

Description: Replacement of CI's obsolete nonsecure VHF radio system with UHF equipment that incorporates the Data Encryption Standard secure voice feature.

Item: EP/ED DETERMINATION SYSTEM OPE-02

Obligations:	1987	1988	1989	1990	1991	1992
	1281	1166	4367	1317	1317	1317

Description: Automate the Employee Plans/Exempt Organizations determination area in both the National Office and the key district offices through the use of minicomputers.

Item: AUTOMATED UNDERREPORTER PROGRAM OPEX-02

Obligations:	1987	1988	1989	1990	1991	1992
	156	1442	2964	3429	3429	3429

Description: Retains tax account and third party data on-line and provides for electronic research of cases.

Item: COMPUTER ASSISTED AUDIT PROGRAM-PRIMARY OPEX-04

Obligations:	1987	1988	1989	1990	1991	1992
	7808	6594	6634	4964	5094	5134

Description: CAAP system maximizes the use of computers in the examination of books and records. It is used to analyze computer files of taxpayers under examination when time is not available on the taxpayers computers.

Item: INFORMATION RETURNS PROGRAM MIS OPEX-08

Obligations:	1987	1988	1989	1990	1991	1992
	3223	2088	2119	2039	2039	2039

Description: Develop and implement a management information system to provide standardized, detailed, cohesive data on IRP workload volumes, costs, and benefits.

Item: MULTIFONT OCR OF IRP DOCUMENTS OPEX-10

Obligations:	1987	1988	1989	1990	1991	1992
	4648	2321	1596	1559	1690	1897

Description: Automate the manual conversion of data from paper information returns to magnetic media through the use of OCR technology.

Item: REPORT WRITING EQUIPMENT (NCR) OPEX-12

Obligations:	1987	1988	1989	1990	1991	1992
	800	800	1300	1300	1300	1300

Description: Continues the use of automated equipment in the computation of proposed tax changes and printing of the "Explanation of Adjustments" for the taxpayer.

Item: W-4 UPDATEABLE DATA BASE OPEX-14

Obligations:	1987	1988	1989	1990	1991	1992
	3169	1400	1556	1884	2294	2807

Description: Establish an automated Service wide updateable data base at NCC or multiple data bases connected by a network of W-4 activities accessible by all ten service centers.

Item: AUTOMATED EXAMINATION SYSTEM OPEX-16

Obligations:	1987	1988	1989	1990	1991	1992
	51378	124767	171762	186662	167708	166314

Description: Applies contemporary technology to the examination process and is designed to integrate with existing Service programs.

Item: AUTOMATED TRAINING SYSTEM PMHR-01

Obligations:	1987	1988	1989	1990	1991	1992
	1238	3657	3929	3683	2565	3570

Description: Design, deliver, manage and evaluate computer based training materials and training support for all IRS training activities.

Item: PERSONNEL MGMT. INFO. TELECOMM. SYSTEM PMHR-09

Obligations:	1987	1988	1989	1990	1991	1992
	3588	3266	3019	3019	3019	3019

Description: A Treasury wide interactive personnel system.

Item: TREASURY WIDE PAYROLL DEVELOPMENT SYSTEM PMHR-11

Obligations:	1987	1988	1989	1990	1991	1992
	3340	10944	5219	5319	5426	5547

Description: Provides for the design, implementation and maintenance of the Treasury Wide Payroll System as well as the development of an accounting subsystem and MIS to meet the needs of management.

Item: AUTOMATED ACCOUNTING & BUDGET EXEC. SYS. PMPFR-01

Obligations:	1987	1988	1989	1990	1991	1992
	615	2366	2559	2320	1628	1201

Description: Continues the ongoing operation of providing standardized financial reporting, accounts maintenance and funds disbursement for the Service's financial management organization.

Item: AUTOMATED FINANCIAL SYSTEM PMPFR-02

Obligations:	1987	1988	1989	1990	1991	1992
	1900	2390	2786	2949	7801	2756

Description: A state-of-the-art computer system to handle accounting, budgeting, and management information services.

Item: DATA CENTER SPERRY 1100/90 PMPFR-05

Obligations:	1987	1988	1989	1990	1991	1992
	4075	2344	5119	4714	4690	4308

Description: This system will replace the Sperry 1100/84. In addition to the current applications being processed on the 1100/84, the new system will provide support to the development of the Treasurywide Payroll System, PERMITS, and other Treasury Administrative Processing Center (TAPC) applications.

Item: DATA CENTER IBM-COMPATIBLE SYSTEM PMPFR-07

Obligations:	1987	1988	1989	1990	1991	1992
	3830	7186	8896	8031	7336	6756

Description: All IRS applications currently performed on the Sperry equipment at the Data Center will be migrated to this system to leave the Sperry system available exclusively for the Treasury Administrative Processing Center applications.

Item: CENTRALIZED INVENTORY DISTRIBUTION SYS. PMS-02

Obligations:	1987	1988	1989	1990	1991	1992
	10612	18853	22306	20618	19940	18151

Description: Redesign the Service's forms distribution network into a new consolidated centralized computer system used to support the distribution of printed products both within IRS and to the public.

Item: INTEGRATED TELECOMMUNICATIONS NETWORK PMS-14

Obligations:	1987	1988	1989	1990	1991	1992
	22135	25957	57159	44773	42373	109606

Description: Provide for the sharing of state-of-the-art communications equipment and circuitry and the integration of voice, data, office automation and video communications.

Item: ELECTRONIC RESEARCH SERVICE(LEXIS,NEXIS,ETC) PMS-15

Obligations:	1987	1988	1989	1990	1991	1992
	2305	2305	4031	4363	4824	5329

Description: Continuation of on-line legal research systems.

Item: SERVICE WIDE-BASIC COMMUNICATIONS SERVICES PMS-22

Obligations:	1987	1988	1989	1990	1991	1992
	124149	134177	130897	127420	123167	119194

Description: Includes costs for basic communication services (voice, data, facsimile and radio) not included in specific information systems initiatives.

Item: FACILITIES INTEGRATED MGT. SYSTEM PMS-24

Obligations:	1987	1988	1989	1990	1991	1992
	122	122	4016	2034	1210	1055

Description: System will interact with or replace many Facilities Management applications such as small purchases, requisition tracking, control and tracking telecommunications, and space management/inventory.

PM:PFR:P
5-21-87

Chairman PICKLE. Now, I am going to make this last statement and then I am going to ask the GAO to come up and testify.

As we see it, we have got to be encouraged that overall the IRS 1988 budget appears to be a vast improvement over those of earlier years. However, the adequacy of those increases and their allocation among competing needs within the IRS needs to be carefully examined.

And this is the statement that disturbs me. For example, this budget—the 1988 budget—has 8,969 fewer positions and is $724 billion lower than that requested by the IRS. Now, if it is that much lower—nearly 9,000—somewhere you must ask the question then, if you do not get that many employees who and where will the work suffer? How will the public be hurt the most? Do you disagree with those figures or do you say that you can adequately do the job with the budget sent up to the Congress?

Mr. GIBBS. Mr. Pickle, as I said, it is difficult for me. I think any time you ask any bureau or agency head, they would dearly love to have the world with a string around it. By the same token, in the Gramm-Rudman-Hollings times that we are in, given the budget increases that we have for fiscal year 1987 with a supplemental, and that we got overall from the budget for 1988, it is very difficult for me to be anything other than supportive of seeing the total budget with the increases that we are getting.

Now, with the additional flexibility of the 5 percent to move the funds around where I need them, yes, I feel the budget is adequate. I mentioned that in the opening statement and I do believe that.

Chairman PICKLE. Well, if you were to get this 5 percent, that would be an increase from what level?

Mr. GIBBS. Well, it is simply a transfer of overall——

Chairman PICKLE. Well, you transferred a lot of people last year. You have got that authority to do a certain amount of it because you did a good whopping number last year. How much more are you asking for this year?

Mr. GIBBS. Currently we have a 1 percent limit on our ability to transfer funds between our four budgetary categories.

Chairman PICKLE. I see, and now you are asking for 5 percent.

Mr. GIBBS. We are asking for 5 percent. To give you an example, let me put some figures on it. This means that out of the other three appropriations we could transfer up to $70 million into taxpayer service, plus find dollars within the fourth appropriation—the one that taxpayer service is in—to transfer into taxpayer service. What I am saying is that they are significant dollars.

Chairman PICKLE. All right. Now, Commissioner I thank you very much for your testimony. I appreciate the job you are doing and we are glad you could appear.

I am going to ask now that the GAO personnel come to the witness t le so we might proceed.

While the witnesses are changing place at the desk I am going to ask that Commissioner Don Alexander come forward at this point. I understand he is going to have to go catch a plane, and Mr. Commissioner we want to hang on to every word you have to give us.

If GAO is agreeable, we will ask them to just stay at the witness table and we will ask Mr. Alexander to make his statement.

We will miss you on the next panel, Commissioner, but I am going to recognize you at this point for any statement you would want to make.

STATEMENT OF DONALD C. ALEXANDER, ESQ., CADWALADER, WICKERSHAM & TAFT, WASHINGTON, DC, FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. ALEXANDER. Thank you very much, Mr. Chairman. I sure appreciate your letting me proceed at this time. I do have to leave town.

Mr. Chairman, I have a statement which I would like to have inserted in the record.

Chairman PICKLE. It will be submitted in its entirety and accepted.

Mr. ALEXANDER. Thank you. In this statement, Mr. Chairman, I discuss two matters that I would like to bring up with you now. One is the question of criminal enforcement of the tax laws.

Now, Commissioner Gibbs pointed out that he had asked for more resources than have been approved, and when you look at the 1988 Internal Revenue budget you find an actual decrease in the number of special agents of the Internal Revenue Service. They have the job of coping with tax evasion, both by organized crime figures and drug dealers, and by otherwise responsible citizens.

Now, if you want our laws to work well, if you want our system to work the way it should and the way that you and Mr. Schulze and others brought out this morning, you are going to have to find an adequate means of coping with tax evasion as well as with tax avoidance.

I am sorry to see the budget move in the wrong direction as far as criminal enforcement is concerned. I am also sorry to see, as you brought out so vividly a few minutes ago, a step in the wrong direction as far as taxpayer service is concerned.

I recognize that during the decade of the 1980's somehow taxpayer service was thought to be not a part of the function of the Internal Revenue Service, despite, as you pointed out so well this morning, the word "service" is in the title of this agency. Taxpayer service deserves to be one of its principal functions.

For whatever reason—I suppose the concept of privatization or something—service was diminished. I do not think that you can call on 150 million Americans, including those, of course, that file joint returns, to file returns that are complete, that are accurate and that comply with our very complex tax laws and at the same time tell them, we are sorry but we cannot tell you how to go about that job.

So I agree completely with the thrust of this Sub-committee's views this morning, that taxpayer service should be strengthened, not weakened, and I am sorry to say that the only way that apparently IRS is going to be able to cope with that next year is to transfer funds.

I believe that the Commissioner should have the right to transfer funds up to 5 percent. That is a step in the right direction, but I am sorry he has to exercise that right, because if he takes it away from function A to give to taxpayer service, that weakens function A.

Finally, as Representative Dorgan said this morning, Former Commissioner Kurtz and I have been working with him on his ad hoc task force. We are glad to assist in that very constructive effort and I hope that the recommendations which will be produced by that task force will be carefully considered up here at the Hill.

Thank you sir.

[The statement of Mr. Alexander follows:]

STATEMENT OF DONALD C. ALEXANDER
CADWALADER, WICKERSHAM & TAFT
Before the
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
April 23, 1987

My name is Donald C. Alexander and I am a partner in the Washington office of Cadwalader, Wickersham & Taft. I am appearing at the request of the Subcommittee in my personal capacity as a tax practitioner and former Internal Revenue Service executive.

As I stated before this Subcommittee on February 6, hearings like those which the Oversight Subcommittee is conducting today are highly beneficial to our tax system. It is particularly desirable that this Subcommittee examine the basic issue whether the resources provided the Internal Revenue Service are sufficient to permit it to carry out its massive responsibilities to the American public. Particularly in the recent past, IRS budgets have been curtailed to such an extent as to substantially weaken tax administration and enforcement. The effects of such misguided reductions are known to all; the serious problems evidenced in the 1985 filing season are not yet forgotten. Audit coverage has shrunk to an unacceptably low number which seriously endangers the success of a system which depends upon the belief of the many taxpayers who do comply that those who would shirk their duties to their nation would be called upon to correct their behavior. The delivery of taxpayer service has been inadequate; it is simply unacceptable for the Government to insist that almost 150,000,000 individuals file correct and complete Federal income tax returns but refuse to tell such individuals how to do so.

As I stated on February 6, it is good to see a long-overdue substantial increase in the Internal Revenue Service budget. At last the Administration is viewing the Internal Revenue Service as a profit center which, indeed it is. Adding to IRS resources can result in seven dollars, or even more, of additional revenue collected for every additional dollar spent. Of course, to the extent these additional resources are assigned to collection, the marginal yield -- for the time being, at least -- will be much higher. Nevertheless, concentrating on the margin is not necessarily the best course; while additional resources are undoubtedly needed in IRS' enforcement activities, additional resources are also needed to process tax returns and to deliver adequate taxpayer service.

As to taxpayer service, I am pleased to hear that IRS has redirected resources to correct the recent decline in the number of taxpayers it assists. I hope this level will be increased further in 1988, but the budget document suggests otherwise. Although it may not be possible to measure the increased compliance (and revenue) that results from adequate taxpayer service, basic fairness requires that a government which calls on its citizens to file complete and correct tax returns should not turn away when its citizens seek aid from it to meet their responsibilities.

Although the 1988 Budget would strengthen IRS generally, there is substantial need for improvement in several respects. One, that cries out for action, is strengthening the ability of the Internal Revenue Service to cope successfully with those who wilfully evade their tax responsibilities. Some of these evaders are drug dealers and organized crime figures, but many are apparently law-abiding citizens who choose to cheat

their country and their neighbors. The 1988 Budget calls for only 2,838 special agents to combat tax evasion, a decrease of two from the number authorized in 1987. Projections in the budget document fail to rectify this serious omission. Particularly if IRS is called upon to shoulder some of the work of other agencies in coping with the serious national problems created by organized crime and drug dealers, IRS must have resources sufficient to accomplish such task and sufficient to make tax evasion a losing game for all. Nothing undermines a tax system faster than the perception that evading taxes goes undetected and unpunished.

As I stated before you in February, I think the annual budget process, together with low entry pay, creates substantial -- and unnecessary -- difficulties for IRS. Hiring good people requires IRS to be able to make offers at the right time and the right salary. If IRS is out of the market, IRS won't be able to find the competent and dedicated people that it needs. The budgetary process is not designed to permit IRS to compete effectively for top accounting graduates. IRS hires too late in the year. More important, IRS is not really in the market. The starting salaries at the basic entry levels are not competitive with the private sector. If under present rules entry level pay cannot be raised to attract the people IRS needs to interpret and administer the 1986 Internal Revenue Code, innovative legislative solutions should be fashioned.

Finally, I note that various bills have been introduced under the label of taxpayers' bills of rights. In my judgment, these measures are mislabeled; these bills would protect the "rights" of noncompliers and undermine the rights of the many who meet their tax responsibilities. I hope that these bills are simply vestiges of April and disappear with the cherry blossoms at the end of the filing period. If not, may I suggest that Congress obtain an estimate (if one has not already been obtained) of the revenue cost of these measures. I believe such cost would be very substantial. Who would pay it? Should those who comply with the system be called upon to pay more so that those who would use new administrative loopholes to game the system could further avoid taxes?

The revenue cost would be substantial primarily because the burden of proof in tax cases would be shifted from the taxpayer -- who has the information and the records -- to the IRS, which does not. Also, IRS personnel would be subject to legal harassment if they carried out their duties to investigate and cope with tax resistance groups like the Posse Comitatus. Under these bills, how could IRS cope with the Universal Life Church which ordains anyone who applies (including at least one poodle and, I believe, a Pekinese).

I am not suggesting that IRS is perfect. Far from it. But I continue to believe it does its difficult job well, and that diligent and constructive oversight by this Subcommittee will enable it to do a better job for the American public in the future.

Chairman PICKLE. Thank you, Commissioner.

I appreciate your observation about the transfer of funds and also the inadequacy of both taxpayer services and criminal investigation. We will look into that further and I think your comments will probably be shared with others. We appreciate your coming here.

Let me ask Mr. Schulze if he has any questions of you.

Mr. SCHULZE. Thank you, Mr. Chairman. No, only to thank Don. He is always available and willing to help and has been over the years. We appreciate that. His service to us and to his Nation has been invaluable. Thank you, Don.

Mr. ALEXANDER. Thank you very much.

Chairman PICKLE. Commissioner, we are going to ask that you continue to respond to questions and assist us as a former Commissioner.

We will do that of the other Commissioners who will be with us. We would like your individual analysis, not from a point of view trying to be critical or complimentary, but just as an honest assessment of where are we going and what should we be doing, so we may be asking you additional questions.

Mr. ALEXANDER. I will be glad to respond, Mr. Chairman.

Chairman PICKLE. Thank you so very much.

Now the Chair will ask that Jennie S. Stathis, Associate Director of the General Government Division, GAO, please take a seat at the witness table. We will proceed with your statement.

I notice that you have a rather extensive statement with charts. Your entire statement will be included in the record, and if you would like to summarize we would be glad to hear from you, and then we would like to ask for you to stay in order to respond to anything that the Commissioner might want to say to you or to inquire of you, or however he wants to approach it.

STATEMENT OF JENNIE S. STATHIS, ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY TED GONTER, GROUP DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, AND DAVID ATTIANESE, GROUP DIRECTOR, GENERAL GOVERNMENT DIVISION

Ms. STATHIS. Certainly. We are pleased to be here this morning to help in your hearing.

I would like to summarize by highlighting certain sections.

Chairman PICKLE. Will you identify the people at the witness table with you, please?

Ms. STATHIS. I certainly will. On my left is Ted Gonter. He is a Group Director in our Information Management and Technology Division, and on my right is Mr. David Attianese, who is a Group Director in our General Government Division.

My testimony today will emphasize five points. First, although we support increased funding for IRS enforcement activities, we are not sure that the proposed allocation within and among the various enforcement activities is the most appropriate, and that is because of limitations in the models used to develop the budget and uncertainties about accounts receivable.

Also, we have reservations about IRS' ability to actually increase its enforcement staff to the extent indicated in the budget or to demonstrate that the additional resources actually generated as much revenue as estimated.

Second, we are concerned about the returns processing workforce, a workforce that is significantly seasonal and inexperienced. We believe that more attention should be focused on stabilizing that staff with a view toward improving the quality of work generated.

Third, the importance of taxpayer service and helping taxpayers comply with tax laws and the potential implications of the Tax Reform Act as you have been discussing this morning, Mr. Chairman, causes us to question the adequacy of that budget.

Fourth, while we are very supportive of the ADP and information technology portion of the budget, we believe the progress of the important projects in that budget bear monitoring.

Fifth, the 1986 Tax Reform Act has created uncertainties for the IRS budget. IRS has attempted to forecast the impact of the Act on its activities. Should actual events deviate from the forecast or time prove insufficient to test the rewritten computer programs, problems and budget demands may be placed on returns processing and taxpayer service functions.

I would now like to discuss the increases proposed for the enforcement activities. As you have been discussing, there are a number of positions proposed for increased examinations, collection of accounts receivable, document matching, and expedited resolution of tax shelter cases.

We have a number of points about that and the first one deals with the resource allocation models. IRS has designed an enforcement resource allocation model to identify the optimal distribution of enforcement resources and the marginal yield associated with that distribution. Because the model was completed in November of 1986 it was not used to develop the 1988 budget.

The model also does not include the collection of accounts receivable, a feature which we believe IRS needs to reconsider. Individual resource allocation models for the collection and information returns activities were not used because IRS found them too cumbersome and complex.

As to the composition of accounts receivable, IRS has established, as the Commissioner mentioned this morning, a study group and initiated a quality improvement project to analyze the composition of accounts receivable and reasons for its growth. IRS does not expect to complete that analysis until the Spring of 1988.

Some of the accounts receivable are more than likely never going to be collected—for example, those where a corporation is defunct or a taxpayer deceased. It also seems likely that the actual value of accounts receivable is something other than what is reported. It is unclear to us, however, whether the reported figure is over or understated.

The study group, for example, identified receivables caused by posting errors that were not really outstanding debts. On the other hand, the amount reported does not include all accrued interest.

Moving on to our third point as to the allocation of the proposed collection resources——

Chairman PICKLE. Ms. Stathis, where are you now? You are skipping mighty fast here.

Ms. STATHIS. I am now on page 9, the caption as to allocation of proposed collection resources. And there, given the uncertainty about receivables, we cannot be certain that IRS needs that many additional collection resources or that its plan for allocating them is most efficient and effective.

IRS proposed allocating a thousand of the additional collection positions to delinquent returns and the remaining positions to accounts receivable. That allocation was subsequently revised to direct all of those positions to accounts receivable.

Consequently, IRS will not receive any additional resources to help it identify and pursue non-filers. IRS estimates that half the additional positions will be revenue officers and half will be allocated to the automated collection system and support functions.

We are not in a position to advise you to the most appropriate allocation of additional resources. I do want to add another point here. You had the conversation this morning about collection resources and how many IRS should have.

We are not really sure of the best basis for estimating those needs but it might be that the number of accounts in the delinquent accounts sub-portion of accounts receivable is really a more appropriate criterion for the number of revenue officers and the number of people in the automated collection system that you really need.

Chairman PICKLE. Well, let me interrupt you just to try to get the idea. You are talking broad figures here. You do not agree with the number of people on their collection staff. You say that is more than they need. Do you then say how many they should have, or do you just say this is more than they need?

Ms. STATHIS. No. We are not in a position to tell you, and I do not think that I am in a position——

Chairman PICKLE. You are just saying they are asking for too many?

Ms. STATHIS. I am just telling you there are questions that can be asked as to whether they need that many more. For example, the number of accounts in the delinquent accounts subsection of accounts receivable—which is where most of these resources would be deployed—the number of accounts has not changed that much since 1982, and that supports what the Commissioner was telling you, that the average value of each of these accounts has increased substantially.

So whether it takes more time and effort for a revenue officer to go out and collect $3,000 from a taxpayer or to go out and collect $6,000 from a taxpayer, we are not really sure.

Chairman PICKLE. All right. Go ahead.

Ms. STATHIS. Okay. I will go on to the next point about the ability to assimilate additional enforcement staff. As the Commissioner has been discussing this morning, there are several factors that affect the IRS ability to effectively recruit and assimilate the large number of staff called for in the budget.

One factor relates to IRS' inability to make firm commitments at a time that would enable it to better compete with the private sector in recruiting college seniors. A second factor involves train-

ing. A significant amount of a new hire's time is spent being trained, either in the classroom or on the job, and that training has to be provided by experienced revenue agents.

To the extent that the experienced agents are training and coaching, they are not conducting audits, a factor that IRS says it considers in developing its annual examination plan and budget. One factor this year is that these experienced agents will also have to be trained themselves to deal with the changes brought on by the 1986 Tax Reform Act.

The third factor that could affect IRS' ability to achieve these increased staffing levels is the possibility that enforcement resources will have to be diverted to fill needs in other areas, such as we have been discussing this morning.

Our final point about enforcement resources relates IRS' ability to track the revenues. The budget cites various estimates of increased revenues the Government can expect to collect as a result of the additional resources. Although we believe the additional resources will generate additional revenues we cannot assure you that the specific estimates cited in the budget are reliable.

The revenue estimates are in terms of additional collections while the revenue data that IRS tracks in the examination portion of its budget is presented in terms of taxes recommended and assessed. We believe the ability to evaluate requests for additional resources would be enhanced if IRS were to show how much it actually collected as a result of various initiatives.

I want to add here that it may be important not to so emphasize short term revenues that quality is threatened. If IRS is allowed to take the time to hire the best people and train them properly it could pay off in the long term in better audits, better collections, better protection of taxpayer rights, increased compliance and therefore increased revenues in the long term.

I would now like to talk about Service Center quality. As you have been discussing this morning, the 1987 filing season was apparently very successful following a successful 1986 season, and IRS has initiated a number of quality improvements. So I do not intend this section to be critical of the current situation.

We also want to emphasize that at a time when the Service Centers appear to be functioning fairly smoothly, this may be a good time to think about the seasonal staff there and whether there are improvements that can be made. We have concerns about the inexperienced seasonal staff. Historically seasonal employees have constituted a large segment of Service Center staff.

In the past many of them returned from year to year bringing their experience with them. The percentage of new hires has been increasing and we have some statistics in our statement about the speed and accuracy rates that have been used to determine whether newly hired data transcribers were ready to process real tax returns. Those statistics show that keystrokes per hour have ranged from 2,400 to 4,600 from one Service Center to another, and error rates have varied from 10 to 25 percent.

When you have inexperienced staff with those kinds of speed and accuracy rates, you are going to decrease production and increase the risk of error overall. The benefits from taking steps to stabilize that workforce are evident. Without such stability, IRS will find

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itself using more and more resources to avoid or correct errors caused by inexperience.

I would like to discuss taxpayer service. We believe that the tax system hinges on the willingness and ability of taxpayers to voluntarily comply with the law. Taxpayer service is the primary vehicle for assisting taxpayers in understanding and complying with those laws. In reviewing other year's budgets this Subcommittee has questioned whether the funds provided a sufficient level of service. We believe that is a question again appropriate this year.

With the additional resources in this budget, as you mentioned earlier, IRS estimates that it will only be able to achieve a 65 percent level of service in 1988 in comparison to the 80 percent it considers minimally optimal.

Going on to the ADP and information technology budget, as I mentioned earlier, this is a section of the budget for which we are very supportive. It is a portion of the budget that is growing each year, and rightfully so, as IRS attempts to modernize its various processes.

As you have been discussing, the budget provides for a number of important projects; replacing the front-end processors and computer terminals at the Service Centers; leasing and maintaining computers to process tax return information; redesigning the tax processing system; maintaining and enhancing the automated collection system; developing the integrated collection system; and continuing to implement the automated exam system.

Given all of those automation efforts and the critical stages that they are in we believe that 1988 may be the most pivotal year to date in, IRS' increasing dependence on computers. In view of ADP's growing importance to the IRS mission and the dollars involved, we are suggesting here the report that you this morning asked the Commissioner for, which will compare resource needs and resources spent on these various projects.

The last section of our statement deals with the impact of tax reform. As you all know, that very sweeping law will have a great effect on IRS as it attempts to implement it.

IRS must extensively reprogram computers, develop and print new regulations and forms, review employee benefit plans, educate taxpayers, respond to what is expected to be a significant increase in taxpayer requests for assistance, and train IRS employees.

IRS has developed a plan for implementing the Act which identifies specific actions that must be taken, assigns responsibility for those actions, and establishes milestones. The plan is being refined. It is expected to become final in May. Some of the actions called for in the plan have already been completed and others are being worked on.

Our point with respect to tax reform is that as IRS implements all of these changes, unforeseen problems may arise that will require resources beyond those provided in the budget.

In estimating its needs, for example, IRS did not anticipate the cost it was going to incur to redesign the form W-4. The potential impact of other types of activities like that could be very significant and cause IRS to divert its resources away from the revenue producing functions.

In implementing tax reform, IRS, among other things, will need to adequately test revised computer programs before they are put into production. That will be very critical to the effective operation of those programs.

In conclusion, Mr. Chairman, although increasing the IRS budget for 1988 may be warranted, we cannot verify the extent to which the increases will enhance IRS' ability to collect additional revenues and ensure greater compliance.

We also want to emphasize the importance of allocating sufficient resources to taxpayer service, and then we have made three other budget-related points; one involving the need to stabilize the Service Center workforce, another on the progress of ADP projects, and the last one on the uncertainties caused by the Tax Reform Act.

That concludes my summary of the statement. Mr. Gonter, Mr. Attianese, and I would be happy to answer your questions.

[The statement of Ms. Stathis follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M., EDT
THURSDAY, APRIL 23, 1987

STATEMENT OF
JENNIE STATHIS, ASSOCIATE DIRECTOR
GENERAL GOVERNMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE HOUSE COMMITTEE ON WAYS AND MEANS
ON THE ADMINISTRATION'S FISCAL YEAR 1988 BUDGET REQUEST
FOR THE
INTERNAL REVENUE SERVICE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in considering the Administration's fiscal year 1987 supplemental and fiscal year 1988 budget requests for the Internal Revenue Service (IRS). Together, the two requests call for increasing IRS' staffing by 10,395 average positions, to a total of 110,661 positions, and increasing IRS' funding to $5.1 billion. About 84 percent of the increased staffing and 49 percent of the increased funding in the fiscal year 1988 budget are targeted for enforcement activities that are intended to increase revenues by $2.4 billion in fiscal year 1988 and by about $14 billion through fiscal year 1992.

My testimony today will emphasize five points.

-- First, although increased funding for IRS' enforcement activities may be warranted, we must qualify our support for the increases provided in the fiscal year 1988 budget. As we have noted in prior years' testimony, IRS has not developed an analytical framework and does not have the necessary information to determine whether the proposed allocation of additional resources within and among all of IRS' various enforcement activities is the most appropriate. For example, IRS does not include accounts receivable in the model it has developed to identify the optimal distribution of enforcement resources and the marginal yield associated with that distribution. Moreover, IRS has not yet determined the true amount and composition of its accounts receivable, which is paramount to deciding how many and what kind of collection resources it needs. Also, we have reservations about IRS' ability to actually increase its enforcement staff to the extent indicated in the budget request, and we question the adequacy of IRS' information systems to demonstrate that the additional enforcement resources actually generated as much revenue as estimated in the budget.

-- Second, we are concerned about the returns processing workforce--a workforce that is significantly seasonal and inexperienced. We believe that more attention should be focused on stabilizing service center staffing with a view toward improving the quality of work generated by that staff.

-- Third, the importance of IRS' Taxpayer Service function in helping taxpayers comply with the tax laws and the potential implications of tax reform on the demand for taxpayer service cause us to question the adequacy of the budget request as it relates to that function. IRS has already experienced considerable demand for assistance in interpreting the Tax Reform Act, and that demand is likely to grow next year when taxpayers, for the first time, have to prepare their returns in compliance with the act.

-- Fourth, ADP and Information Technology has grown to account for about 17 percent of IRS' overall budget. Given the increasing importance of ADP in IRS and the challenges facing IRS with respect to several of its ADP projects, we believe that the progress of these projects should be closely monitored.

-- Fifth, the 1986 Tax Reform Act casts a cloud of uncertainty over IRS' budget. IRS has attempted to forecast the impact of that act on its activities; but recent events surrounding the new Form W-4 provide a vivid example of how those forecasts can go awry. One critical step in IRS' implementation of tax reform involves the rewriting of many computer programs. One of the reasons IRS ran into problems when it implemented the Service Center Replacement System in 1985 was the fact that rewritten computer programs were put into production without being adequately tested. We do not know whether IRS will have sufficient time

this year to adequately test the programs it will be rewriting because of tax reform. Inadequately tested programs could cause problems that will put unforeseen demands on IRS' returns processing and taxpayer service functions.

INCREASES PROPOSED FOR ENFORCEMENT ACTIVITIES

In an attempt to reduce the federal deficit through increased revenues, IRS' fiscal year 1988 budget calls for a significant increase in resources devoted to revenue-producing enforcement activities. Those increased resources include

-- 3,002 positions and $121 million for the second year of a 3-year examination initiative, which IRS expects will increase audit coverage from 1.44 percent in fiscal year 1987 to 1.61 percent in fiscal year 1988 and increase tax collections in fiscal year 1988 by $443 million;

-- 2,967 positions and $122 million to accelerate the collection of $1.125 billion in accounts receivable;

-- 1,362 positions and $35 million to expand document matching, with a special emphasis on underreported income and an expected increase of $224 million in revenues;

-- 487 positions and $23 million to expedite resolution of tax shelter cases and to accelerate collection of $519 million in revenues; and

-- 172 positions and $5 million to expand examinations conducted by the service centers, which IRS expects will generate $70 million in additional revenue.

Although these increases are likely to enhance IRS' enforcement efforts, we are not sure to what degree. I would now like to discuss various factors contributing to that uncertainty.

Resource allocation models need refining

In testifying last year on IRS' fiscal year 1987 budget, we noted that IRS was planning to implement an Enforcement Resource Allocation Model in June 1986. That model, which is designed to identify the optimal distribution of enforcement resources and the marginal yield associated with that distribution, was completed in November 1986 and thus was not used when IRS developed its fiscal year 1988 budget submission. Consequently, that part of IRS' budget request relating to enforcement activities was developed using output generated by various models or micro-based adaptations of models developed for specific enforcement activities.

IRS' enforcement activities are so interdependent and their relationships so complex that an analytical tool, like the Enforcement Resource Allocation Model, should greatly facilitate sound decisions on the level of budgetary support each activity should receive. We believe, however, that IRS needs to reconsider one feature of that model.

The Enforcement Resource Allocation Model, as we understand it, provides IRS with a capability to determine the best way to allocate additional resources among all of its enforcement activities except one--the collection of accounts receivable. According to an IRS briefing document, accounts receivable are excluded because IRS does not think additional resources for the examination function, which assesses new taxes, should compete with additional resources for pursuing assessments that taxpayers have already agreed they owe. IRS associates examination resources with additional revenue and accounts receivable resources with revenue it already expects to receive. We question whether IRS can estimate the optimal distribution of enforcement resources with a model that does not consider all enforcement activities.

IRS' Research Division worked with contractors to develop the Enforcement Resource Allocation Model and individual resource allocation models for the Collection and Information Returns activities. Examination's model was developed in-house and has been used for several years. On the other hand, Collection and Information Returns found their models too cumbersome and complex to work with, so they developed micro-based adaptations of these models. IRS' contractual costs to develop the Collection and Information Returns models amounted to $607,000 and $391,000 respectively. These cost figures exclude computer time and IRS staff costs. IRS has started to design a

new Information Returns model and is considering several alternatives for developing a new Collection model.

Composition of accounts receivable still unclear

In our testimony last year before this Subcommittee, we noted that IRS' accounts receivable, which are taxes that have been assessed but not collected, had risen dramatically to $45 billion in December 1985. More recent information obtained from IRS shows that the dollar value of its receivables had increased to $47.6 billion as of September 1986 and is expected to approach $51 billion by the end of fiscal year 1987 and $53 billion by the end of fiscal year 1988.

Since our testimony last year, IRS has established a study group and initiated a quality improvement project to analyze the composition of its accounts receivable and to identify reasons for the growth in those accounts. IRS does not expect to complete its analysis until the spring of 1988. Hopefully, that analysis will provide IRS with reliable information on (1) the content of and reasons for the growth in its accounts receivable and (2) the kinds of operational changes needed to better assure that receivables are more accurately reported in the future. IRS needs this information to allocate resources effectively.

According to IRS officials, IRS reports its receivables in accordance with guidance established by the Department of the Treasury, the Office of Management and Budget, and GAO. IRS officials informed us, however, that its quarterly report to Treasury contains some inaccurate information, specifically with respect to interest and penalties, and that IRS has notified Treasury that it will discontinue reporting this information until the problem has been corrected.

Some of the categories IRS uses to classify its receivables include accounts that are more than likely never going to be collected. One category, for example, includes corporate accounts that are considered uncollectible because the corporation is defunct while another category includes accounts that have been suspended because of bankruptcy proceedings. Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies provides for establishing an allowance to reduce receivables by the amount estimated as uncollectible. The allowance must be based on past experience, present market conditions, and an analysis of outstanding balances. IRS has established such an allowance in its report to Treasury, but that allowance may not accurately reflect the value of IRS' uncollectible accounts.

Based on discussions with Collection management and with members of the study group and quality improvement project, it seems likely that the actual value of IRS' accounts receivable is something other than what is being reported. It is unclear, however, whether the reported figure is over or understated. The study group, for example, has identified receivables that were caused by posting errors and thus were not really outstanding debts. On the other hand, the amount being reported as receivable does not include interest that has accrued since the time the tax was assessed. Although computing accrued interest for accounts that are unlikely to ever be collected would inflate the value of receivables, computing such interest for collectible accounts, like those included in the notice, taxpayer delinquent account, and installment categories, would provide a more accurate accounting of money due the government. IRS officials told us that because interest rates have changed more than 50 times over the past 10 years, computing accrued interest would be labor intensive. We do not know how difficult or costly it would be for IRS to compute accrued interest, but doing so would lead to a more proper accounting for receivables.

Based on its inquiries to date, IRS has identified several factors contributing to the growth in accounts receivable. In a February 1987 memorandum to Treasury concerning discussions with the Office of Management and Budget, the Commissioner of Internal Revenue partially attributed the growth to errors committed when posting quarterly federal tax deposits to business accounts. He added that this problem was exacerbated by the processing problems experienced during the 1985 filing season. The Commissioner also mentioned that the average dollar amount of taxpayer delinquent accounts continues to increase. For example, the average delinquent account in fiscal year 1982 was $3,415 compared to $6,152 in fiscal year 1986.

Allocation of proposed Collection resources may not be the most appropriate

The additional 2,967 Collection staff years requested in the fiscal year 1988 budget are all targeted to help IRS pursue accounts receivable. Given IRS' uncertainty about the composition of those receivables, we can not assure this Subcommittee that IRS needs that many additional Collection resources, or assuming it does, that its plan for allocating those resources represents the most efficient and effective use of the additional staff years.

IRS' Collection function is primarily concerned with pursuing accounts receivable and delinquent returns. It is important to recognize that delinquent returns, or non-filers, may pose a more serious threat to voluntary compliance than accounts receivable. With non-filers, returns have not been filed and taxes have not been assessed. Accounts receivable, on the other hand, represent taxes assessed and owed but not yet paid. IRS can readily identify these taxpayers, whereas it must rely on information matching or other compliance programs to identify non-filers.

IRS' fiscal year 1988 budget submission to Treasury proposed allocating 1,000 of the additional Collection positions to the delinquent returns program and the remaining 1,967 positions to the accounts receivable program. That allocation was subsequently revised to provide for directing all 2,967 positions to the accounts receivable program in order to accelerate revenue collections and facilitate meeting Gramm-Rudman deficit reduction targets. Consequently, IRS will not receive any additional resources to help it identify and pursue nonfilers.

IRS estimates that about half of the additional positions designated for the accounts receivable program will be filled by revenue officers. The remaining positions will be allocated to the Automated Collection System and support functions. In the past, IRS has allocated most of its additional Collection resources to staffing the Automated Collection System, which is a less costly means of collecting taxes owed. According to Collection staff, IRS decided to reverse the allocation in 1988 because it considers revenue officers better suited to work on high dollar, complex accounts.

We are not in a position to advise the Subcommittee on the most appropriate allocation of additional Collection resources. We believe, however, that the uncertainty over the composition of accounts receivable and the serious compliance problem caused by nonfilers call into question the decisions to allocate all those resources to accounts receivable and to designate so many of those resources to revenue officer positions rather than to the more cost effective Automated Collection System.

IRS' ability to assimilate additional enforcement staff

In September 1986, the Commissioner of Internal Revenue forwarded to this Subcommittee estimates of the maximum number of staff IRS could assimilate between 1987 and 1991. The additional enforcement resources called for in IRS' fiscal year 1988 budget request approximate the numbers in that document. These figures were based in part on recommendations made by the President's Private Sector Survey on Cost Control as well as the best estimates of IRS' functional managers.

In reviewing IRS' implementation of the fiscal year 1987 phase of the 3-year examination initiative, we identified several factors that could affect IRS' ability to effectively recruit and assimilate the large numbers of staff called for in the 1988 budget. One factor relates to IRS' inability to make firm hiring commitments at a time that would enable it to better compete with the private sector in recruiting college seniors who are due to graduate in May or June. Accounting firms make offers during the winter months preceding a college senior's spring graduation. IRS cannot make a firm commitment, however, until late summer or early fall when it knows how many people it is authorized to hire.

A second factor involves training. A significant amount of a new hire's time is spent being trained, either in a classroom or on the job. IRS estimates that newly hired revenue agents spend 33 percent of their time conducting examinations during the first year and newly hired collection staff work at 65 percent capacity in the first year. Classroom training of newly hired revenue agents and the coaching of newly hired agents during on-the-job training is provided by experienced revenue agents. To the extent experienced agents are training and coaching, they are not conducting audits--a factor that IRS says it considers in developing its annual examination plan and budget.

A couple of issues relating to revenue agent training need to be recognized as IRS moves into the second and third phases of its examination initiative. Because an agent's training spreads over several years, the hiring of a second large class of new agents will increase the training workload and the need to divert experienced agents from doing audits. The second class will be receiving the initial phases of its training while the first class is receiving a subsequent phase of its training. Also, experienced agents who are responsible for training the new hires will have to be trained themselves to deal with the changes brought on by the 1986 Tax Reform Act.

A third factor that could affect IRS' ability to achieve the increased staffing levels provided in the 1988 budget is the possibility that enforcement resources will have to be diverted to fill a need in areas like Taxpayer Service and Returns Processing. Last year, for example, the Commissioner saw a need to increase the level of telephone assistance provided by Taxpayer Service and to insure that the service centers were sufficiently staffed so as to avoid a recurrence of the returns processing problems that affected IRS in 1985. Consequently, other functions, such as Examination, were unable to fill attrition vacancies until IRS received its supplemental appropriation for fiscal year 1986. That supplemental included funds to allow IRS to advance hire about 1,600 additional revenue agents for the first phase of the examination initiative. Before it could hire additional agents, however, Examination had to fill its vacancies. Because of that, IRS, as of January 1, 1987, had increased its on-board strength of revenue agents by 799--less than half of the budgeted increase. This could adversely affect IRS' ability to generate the additional examination revenues projected in the fiscal year 1987 budget. Fiscal year 1988 revenues could be similarly affected if IRS has to divert enforcement resources to implement the Tax Reform Act of 1986. That is discussed in more detail later in my statement.

IRS' ability to track revenues

The fiscal year 1988 budget cites various estimates of increased revenues the government can expect to collect as a result of the additional enforcement resources proposed in that budget. Although we believe the additional resources will generate additional revenues, we cannot assure this Subcommittee that the specific revenue estimates cited in the budget are reliable. The estimates were computed based on various assumptions that we did not validate. Examination, for example, based its revenue estimate on the assumption that IRS eventually collects 95 percent of the tax assessed as a result of audits.

One way to assess the reliability of an IRS estimate is to compare it with actual accomplishments. Although such a comparison comes too late to be of any value in making decisions based on that particular estimate, it does provide a base for determining the level of confidence that can be attributed to future estimates. The information IRS provides Congress in its budget documents, however, does not lend itself to that kind of analysis. IRS is claiming, for example, that the fiscal year 1988 phase of the 3-year revenue agent initiative will generate additional collections of $443 million in fiscal year 1988 and that continued implementation of the Automated Examination System will generate $58 million in additional revenue in fiscal year 1988. The revenue data that IRS tracks from year to year in the Examination portion of its budget, however, is presented in terms of additional taxes recommended and additional taxes, penalties, and interest assessed--amounts that may or may not translate into actual collections in the future. We believe this Subcommittee's oversight of IRS and the Congress' ability to evaluate future requests for additional staff or automation would be enhanced if IRS were required, from year to year, to show how much it actually collected as a result of its various staffing and automation initiatives and to explain how those figures were computed.

RETENTION PROBLEMS AFFECT
SERVICE CENTER QUALITY

During this Subcommittee's hearings on IRS' fiscal year 1987 budget, one of the main issues centered around the adequacy of service center staffing levels. We believe that service center staffing still deserves special attention, but with a different focus. In the past we focused our concern on the number of staff years budgeted for the service centers. We are now equally concerned with the quality of that staff's work.

The following information, obtained from various IRS sources, provides the basis for our concern about quality:

-- Historically, seasonal employees have constituted a large segment of a service center's staff. According to an IRS staffing document, for example, 61 percent of the returns processing staff at IRS' ten centers as of February 28, 1987, were seasonal employees. In the past, many seasonal employees would return to the service centers from one year to the next, bringing their experience with them. The percentage of new hires in the seasonal workforce has been increasing, however, from 45 percent in fiscal year 1984 to 65 percent in fiscal year 1986. The percentages in some service centers are much higher. At Austin, Andover, and Atlanta, for example, the percentages of new hires in fiscal year 1986 were 91, 80, and 79 respectively.

-- During the 1985/1986 recruiting season, the speed and accuracy rates used by the 10 service centers to determine whether newly hired data transcribers had successfully passed their training and were ready to process real tax returns ranged from 2,400 keystrokes an hour in Andover to 4,670 keystrokes an hour in Atlanta and from a 10 percent error rate in Memphis to a 25 percent error rate in Philadelphia. In 8 of the 10 service centers, the acceptable error rate was 18 percent or higher.

-- Staff inexperience decreases production and, more importantly, increases the risk of error. During the first 4 months of 1986, for example, inexperienced code and edit staff in the Philadelphia Service Center processed 16 percent less Form 1040s per hour than experienced staff and committed 71 percent more errors.

Among other things, poor quality work at a service center increases the risk of untimely refunds and erroneous notices to taxpayers and can have a significant impact on inventories of adjustments/correspondence and unpostables--inventories that have been the cause of much concern over the past couple of years. Although the service centers have generally succeeded in reducing the size of those inventories, as of January 2, 1987, 8 of the centers had adjustments/correspondence inventories and 9 had unpostable inventories that still exceeded IRS' criteria for manageability.

IRS recognizes the detrimental effect of inexperienced staff on quality. As evidence of that recognition, IRS' budget submission to Treasury included several proposals directed at enhancing the quality of service center work, none of which were approved. Included among those initiatives was one directed at converting seasonal positions to permanent positions. IRS has taken steps in most service centers to convert some seasonals to permanents by training them to perform more than one job. For example, an employee could work as a data transcriber in returns processing for part of a year and an examiner in document matching for the rest of the year. IRS' proposal to Treasury would have given this effort more momentum by providing about $2.8 million to allow for salary increases to convert 1,620 employees to permanent positions.

The benefits from converting seasonals to permanents or from any other steps that might be taken to stabilize the service center workforce are critical. Without such stability, IRS will find itself using more and more of its limited resources to avoid and/or correct errors caused by inexperience. We would suggest that the Subcommittee pursue the service center staffing issue with IRS and Treasury, with particular emphasis on identifying steps that can be taken to stabilize that workforce and opportunities that might exist to convert more seasonal employees to permanents. In its fiscal year 1988 request, for example, IRS is asking for over 1300 additional positions to expand document matching at the service centers. Maybe some of those positions could be filled by crosstraining seasonal returns processing staff and converting that staff to permanent positions.

FUNDING LEVEL FOR TAXPAYER SERVICE MAY BE INSUFFICIENT

This country's tax system hinges on the willingness and ability of taxpayers to voluntarily comply with the tax laws. Taxpayer service is IRS' primary vehicle for assisting taxpayers in understanding and complying with those laws. A major aspect of that service involves assistance to taxpayers who phone IRS seeking information that will help them correctly prepare their tax returns or otherwise meet their obligations. The proposed fiscal year 1988 budget includes 5,704 positions and $260.5 million for taxpayer service.

In reviewing recent years' budget requests for IRS, this Subcommittee has questioned whether the funds being provided for taxpayer service were sufficient to support an adequate level of service to taxpayers. That question seems appropriate again this year.

As a minimum, IRS strives to provide an 80 percent level of service to taxpayers phoning in for assistance; that is, have enough staff to respond to 80 of 100 taxpayers calling taxpayer service at any given moment. According to IRS, the fiscal year 1987 budget for Taxpayer Service only included enough resources to enable IRS to provide about a 65 percent level of service. To raise that level, the Commissioner redirected funds to Taxpayer Service from other IRS activities. According to IRS statistics, for the 13 weeks ended March 28, 1987, Taxpayer Service provided a 77 percent level of service compared to 82 percent during the same period last year.

The budget submission for fiscal year 1988 includes $15.1 million and 411 positions to help Taxpayer Service handle its tax-reform related workload next year. Even with those additional resources, however, IRS is estimating that it will only be able to achieve a 65 percent level of service in 1988. If the Commissioner chooses to reprogram funds to increase that level of service, he may have to do so at the expense of IRS' enforcement activities.

As evidence of the potential impact of tax reform on the demand for assistance, IRS' monitoring of calls received on March 24, 1987, indicated that 17 percent of the calls pertained to the Tax Reform Act. About one fourth of those calls related to the new W-4.

ADP AND INFORMATION TECHNOLOGY

Of IRS' fiscal year 1988 budget, about 17 percent, or $847 million, is targeted to provide staff and fund projects related to ADP and information technology. That is an increase of about $213 million, or 34 percent, over the amount originally included in the budget for fiscal year 1987 and reflects IRS' growing dependence on computers and information technology.

The $847 million includes about $122 million for three projects about which GAO testified before this Subcommittee on February 6, 1987. Those projects involve (1) replacing front-end processors and computer terminals at the service centers, (2) leasing and maintaining the existing mainframe computers used to process tax return information, and (3) redesigning IRS' tax processing system. As GAO noted during its testimony, IRS faces challenges with each of those projects.

GAO noted, for example, that because of hardware and software problems, IRS does not expect new front-end processors to be installed in all service centers until September 1988, or about 1 year after the original scheduled date. Consequently, IRS will have to rely on existing outdated and capacity-limited processors for the 1987 and 1988 tax filing seasons. IRS also must begin to successfully implement several planned initiatives designed to make more efficient use of its existing mainframe tax processing computers. If it can do so, the computers should be able to handle IRS' needs until mid-1991. Otherwise, problems could occur as early as mid-1988. Finally, IRS' plans for redesigning its tax processing system represent an extremely important, yet highly complex and difficult transition from outdated computer technology to state-of-the-art computer and telecommunications technology. IRS envisions this redesign as an evolutionary process and is taking the first step in that process by developing a preliminary design concept, an acquisition strategy, a transition plan, and a management plan. This step, which IRS expects to complete by February 1988, is essential if IRS, Treasury, and the Congress are to understand this long-term overhaul and its budgetary implications.

Information systems are also a large and growing part of IRS' compliance activities. The fiscal year 1988 budget, for example, includes $67 million to maintain and enhance operation of the Automated Collection System, $25 million for the Integrated Collection System which will be pilot tested in the Southwest region, and about $129 million to continue implementing the Automated Examination System.

Given all these automation efforts, fiscal year 1988 may be the most pivotal year to date in IRS' increasing dependence on computers. In view of the growing importance of ADP to IRS' mission and the number of dollars already authorized and to be requested in the future, we believe that the Subcommittee's oversight would be facilitated if IRS were to more fully describe what each of its major automation efforts is intended to accomplish. With each fiscal year budget submission, IRS should spell out the

anticipated budget requirements for each major project as well as any significant changes in previously funded projects and the potential impact on related programs and activities. The Subcommittee could use this information to help judge whether IRS is effectively planning and executing its ADP initiatives and whether IRS can, in fact, successfully improve its ability to process tax returns, make timely refunds, accomplish compliance objectives, and accurately maintain taxpayer accounts in the face of an increasing tax administration workload.

IMPACT OF TAX REFORM

The Tax Reform Act of 1986 was the most extensive change in tax law since 1954. Some of the act's provisions likely to affect IRS and the taxpaying public include: changes in the basic tax rate structure for individuals, elimination or reduction of certain itemized deductions, repeal of the deduction for contributions made to an Individual Retirement Account for many of those participating in an employer-maintained retirement plan, taxation of a minor's unearned income at the higher of the minor's or the parent's marginal tax rate, a requirement that social security numbers be reported for all dependents age 5 and older claimed as deductions, and a requirement that employees submit revised withholding (W-4) forms.

In order to implement the new tax law and to assist the taxpaying public, IRS must, among other things, extensively reprogram its computers, develop and print new regulations and tax forms, review employee benefit plans, educate taxpayers so they can understand and comply with the new law, respond to what is expected to be a significant increase in taxpayer requests for direct assistance, and train IRS employees.

IRS has developed a preliminary plan for implementing the Tax Reform Act which identifies specific actions that must be taken, assigns responsibility for those actions, and establishes milestones. The plan is being refined based on input from the various IRS components and is expected to become final in May 1987. Some of the actions called for in the plan have already been completed and others are being worked on.

In preparing its supplemental appropriation request for fiscal year 1987, IRS had estimated that it would need $119 million to implement the Tax Reform Act. The Administration approved $80 million of that request--the amount that is included as part of the request now before Congress for approval. The fiscal year 1988 budget provides for another $80 million to continue implementing the Act--about $10 million less than Treasury had requested in its submission to OMB.

As IRS implements tax reform, unforeseen problems may arise that will require resources beyond those provided for in the budget. In estimating its resource needs, for example, IRS did not anticipate the controversy that surrounded its new form W-4 and the need to develop a second form--an effort which cost about $6 million according to IRS. The potential impact of unforeseen problems on activities like Returns Processing and Taxpayer Service could be significant and could, as happened in 1986, cause IRS to divert resources away from its revenue-producing functions. As mentioned earlier, that, in turn, would affect IRS' ability to fully realize the additional revenues cited in the budget.

One of the more important steps IRS must take in implementing the act is to revise many of the computer programs used in processing returns. It is critical not only that the programs be revised but also that the revisions be adequately tested before the programs are put into production. One reason IRS encountered problems when it implemented its new service center computer system (called the Service Center Replacement System) in 1985 was the fact that rewritten computer programs were not adequately tested before they were put into production. The new system had to be in operation in January 1985, and IRS had no choice but to put programs into production no matter how well they had been tested and "debugged."

Time is also of the essence with respect to tax reform. The rewritten programs have to be in operation by January 1988. Recent conversations with the Chief of IRS' Testing Branch indicate that there may be insufficient time to test all those programs to the extent desirable. If defective programs are put into production, the impact on IRS operations and taxpayer relations could be severe. For example, inventory levels that the service centers have been trying to bring under control could swell again.

Because of the potentially adverse effects if IRS' implementation of tax reform should run into problems, we would suggest that the Subcommittee require IRS to provide

periodic reports on the status of its implementation of the Tax Reform Act, with specific emphasis on any unforeseen problems.

CONCLUSION

In conclusion, although increasing IRS' budget for fiscal year 1988 may be warranted, we can not verify the extent to which the requested increases will enhance IRS' ability to collect additional revenues and ensure greater compliance with the tax system. We also want to emphasize the importance of allocating sufficient funds and resources to Taxpayer Service. Even though it is a non-revenue producing activity, Taxpayer Service helps taxpayers comply with the tax laws and plays a vital role in the success of a tax administration system that is based on voluntary compliance. Considering the potential implications of tax reform and the sizeable number of tax reform-related calls IRS has been receiving this year, we think the Subcommittee should question the adequacy of IRS' budget for Taxpayer Service.

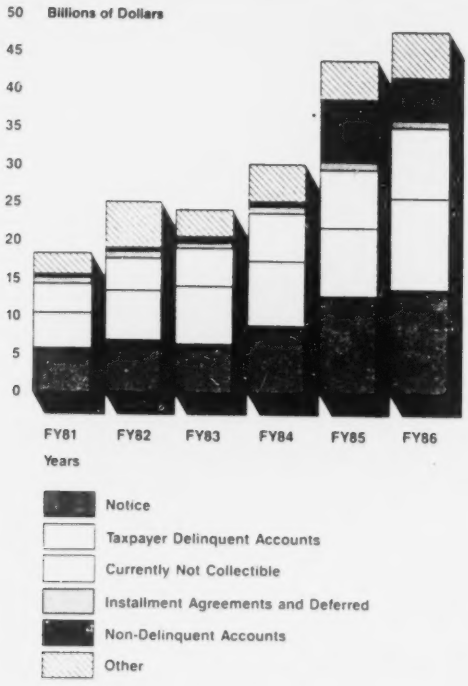
There are three other budget-related issues that we believe would benefit from Subcommittee oversight. First, the Subcommittee should discuss with IRS steps that can be taken to stabilize the service center workforce. To the extent IRS is able to retain experienced service center employees, the quality of its work is likely to improve. Such an improvement should enhance public confidence in the tax system. Second, the Subcommittee should ask IRS to define anticipated accomplishments for each of its major automation efforts and to provide periodic status reports on the progress of these efforts. Computer and information technology comprises an increasing percentage of IRS' total budget and plays an integral role in virtually all of IRS' primary tax administration responsibilities. Third, the Subcommittee should request IRS to provide periodic status reports on its implementation of the Tax Reform Act. A failure to successfully reprogram computers, write regulations, devise new tax forms, or train IRS employees could have serious consequences.

This concludes my prepared statement. I will be pleased to answer any questions.

ATTACHMENT I

ATTACHMENT I

Status of Accounts Receivable, Fiscal Years 1981-1986



*An Accounting Change Was Made in Fiscal Year 85 That Reclassified Balance Due Notices Under 30 Days From Delinquent to Non-Delinquent Status

Source: IRS

ATTACHMENT II

ATTACHMENT II

IRS' ACCOUNTS RECEIVABLE
FY 1981 through FY 1986 (000,000)

Type of Account	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
Notice[1]	$ 5,739	$ 6,890	$ 6,273	$ 8,796	$12,720	$13,661
Taxpayer Delinquent Account[2]	4,679	6,717	7,708	8,512	9,143	11,922
Currently Not Collectible[3]	3,935	4,138	4,995	6,262	7,588	8,995
Installment[4]	569	472	582	683	685	777
Deferred[5]	199	243	251	253	254	392
Non-delinquent[6]	595	598	668	712	8,174	5,746
Other[7]	2,652	6,275	3,621	4,891	4,893	6,152
Total	$18,368	$25,333	$24,098	$30,109	$43,457	$47,645

Source: IRS

[1]Notices: Unpaid accounts for which a notice has been issued by a service center and which are more than 30 days past the latest assessment date. Routine notice cases remain in notice status 13 weeks for businesses or 25 weeks for individuals. Depending on the circumstances this can be accelerated or extended.

[2]Taxpayer Delinquent Accounts: Accounts completing the notice stage which are pursued either through IRS' Automated Collection System or by a collection officer in the field.

[3]Currently Not Collectible: Accounts which IRS has determined to be currently not collectible due to hardship, inability to locate a taxpayer or because a corporate taxpayer is defunct. These accounts are inactive, but are monitored to update status and offset refunds.

[4]Installment Agreements: Accounts for which IRS and the taxpayer have entered into an agreement that provides for the account to be paid off in regular installments.

[5]Deferred: Inactive accounts whose aggregate balance falls below established thresholds and which IRS does not consider cost-effective to pursue.

[6]Non-delinquent: Accounts in notice stage less than 30 days and accounts for which the taxpayer has elected a statutory installment privilege (e.g. payment of estate tax).

[7]Other: Accounts in litigation (e.g. bankruptcy) or accounts with adjustments pending that will satisfy the liability.

ATTACHMENT III

ATTACHMENT III

IRS' ADJUSTMENTS/CORRESPONDENCE INVENTORY[1]

Service Center	Total Inventory 12/20/85	Total Inventory 1/2/87	Controlled Inventory[2] 12/20/85	Controlled Inventory[2] 1/2/87	Overage Cases[3] 12/20/85	Overage Cases[3] 1/2/87	Percentage of Overage Cases[4] 12/20/85	Percentage of Overage Cases[4] 1/2/87
Andover	91,195	53,777	68,396	40,333	13,423	19,240	19.6	47.7
Atlanta	207,191	70,391	155,393	52,793	146,592	25,942	94.3	49.1
Austin	156,061	61,461	117,046	46,096	91,578	15,525	78.2	33.7
Brookhaven	110,176	73,536	82,632	55,152	66,323	41,058	80.3	74.4
Cincinnati	25,827	36,228	19,370	27,171	1,989	3,296	10.3	12.1
Fresno	213,299	55,011	159,974	41,258	144,791	12,152	90.5	29.5
Kansas City	47,067	32,980	35,300	24,735	13,800	2,775	39.1	11.2
Memphis	86,808	55,073	65,106	41,305	54,640	16,773	83.9	40.6
Ogden	85,507	39,587	64,130	29,690	49,792	12,771	80.1	43.0
Philadelphia	93,770	64,832	70,328	48,624	15,175	12,245	21.6	25.2
National	1,116,901	542,876	837,675	407,157	598,103	161,777	71.4	39.7

Source: IRS

[1]IRS considers an adjustments/correspondence inventory manageable when no more than 20 percent of the controlled cases are active beyond 45 days. A case is controlled if it is entered on IRS' Integrated Data Retrieval System along with the identity of the tax examiner working it. A case is supposed to be controlled if it cannot be closed within 14 days of its receipt by IRS.

[2]These numbers were computed based on an IRS estimate that 75 percent of the total inventory is controlled.

[3]Overage cases are those more than 45 days old.

[4]These percents were computed by dividing the number of overage cases by the number of controlled cases.

ATTACHMENT IV

ATTACHMENT IV

IRS' UNPOSTABLES INVENTORY[1]

Service Center	Total Inventory 12/27/85	Total Inventory 1/2/87	Overage Cases 12/27/85	Overage Cases 1/2/87	Percentage of Overage Cases[2] 12/27/85	Percentage of Overage Cases[2] 1/2/87
Andover	97,450	53,678	3,570	17,604	3.7	32.8
Atlanta	247,134	121,241	64,379	42,821	26.1	35.3
Austin	276,403	70,042	103,547	17,884	37.5	25.5
Brookhaven	217,192	90,580	55,012	25,305	25.3	27.9
Cincinnati	57,566	45,962	9,579	10,245	16.6	22.3
Fresno	220,712	76,713	63,828	18,975	28.9	24.7
Kansas City	62,876	64,893	28,393	21,464	45.2	33.1
Memphis	77,886	46,706	17,866	13,532	22.9	29.0
Ogden	75,617	34,464	11,248	6,403	14.9	18.6
Philadelphia	244,130	114,185	44,824	27,415	18.4	24.0
National	1,576,966	718,464	402,246	201,648	25.5	28.1

Source: IRS

[1]IRS considers an unpostables inventory manageable when no more than 20 percent of the cases are overage.

[2]These percentages were computed by dividing the total inventory into the number of overage cases.

Chairman PICKLE. Well, we thank you. You have given us a very detailed statement here with your recommendations and they seem to be at considerable variance with what Commissioner Gibbs has stated earlier, or at least you have very serious reservations about them.

I notice in your conclusion that you question whether the IRS has the ability to collect additional revenues and assure greater compliance with the tax system. So you are really questioning overall the approach that they are taking.

Now, you also state that you wanted to emphasize the importance of allocating sufficient funds and resources to taxpayer services. Are you recommending or in favor of the increasing from 1 to 5 percent of these interdepartmental transfer funds?

Ms. STATHIS. I do not think that GAO would traditionally take a position on that. I think that is something that the Members of Congress will have to decide. On the one hand it decreases Congress' control over the IRS budget because you lose that visibility over those four individual appropriations. On the other hand, as the Commissioner has stated and as we have said in our statement, the Tax Reform Act of 1986 causes so many uncertainties that it may be a year in which that authority is warranted.

Chairman PICKLE. Well, you state that we, the subcommittee, should question the adequacy of the IRS' budget for taxpayer services. You think that the IRS should take steps to stabilize the Service Center workforce, and you question the degree of implementation of the Tax Reform Act.

I do not know from your testimony whether you go into detail with recommendations, but those are rather sobering analyses for us to see. What you are recommending and what you observed is something that we ought to look further into.

Ms. STATHIS. I think, Mr. Chairman, if I could interrupt a little bit, that what we are saying is not quite what you are saying. We are not questioning that they are on track at the moment in implementing the Tax Reform Act. We are just cautioning that because of the great workload that there is there and the difficulties in doing it, that it may cause budget problems for IRS.

Chairman PICKLE. Well, I do not know that there is much ground for misinterpretation of what I have just said because I was reading from your copy. So, I would have to surmise again that you raise serious questions, and that is what GAO is supposed to do. We do not take it in any critical sense other than making a proper analysis.

I am going to ask Commissioner Gibbs to respond to any of these points, but before I do let me ask Mr. Schulze if he has any questions at this point?

Mr. SCHULZE. Thank you, Mr. Chairman, Ms. Stathis.

It seems to me that we can look at the experience with the W-4 in two ways. We can say that about 20 percent or 17 percent of the inquiries were on the W-4 and consequently next year we will not have them. Or we can say that about one-fifth of the inquiries were on the new regulations and next year with many more new regulations going into effect we may have a doubling, tripling, or quadrupling of inquiries.

Would you care to give us your thoughts? What do you think the reaction will be? I believe it is fairly important that we try to give the IRS some guidelines if we can.

Ms. STATHIS. Mr. Schulze, we have recently initiated an effort to look at the way that IRS estimates its demand for taxpayer service. We are just getting started on that effort and I think, as the Commissioner has been telling you, it seems to be an art as much as a science to try to make those estimates. There are so many uncertainties this year that it is very difficult to say. I do not think that I have any better figure than you do or the IRS has.

Mr. SCHULZE. You are telling me your crystal ball is cloudy?

Ms. STATHIS. My crystal ball is very cloudy.

Mr. SCHULZE. Okay. Testing of the new computer programs and software: What are the odds of some software getting through being pretty good but not totally capable and thereby causing some massive disruptions? From your testimony it seems to me you raise that possibility. Is that a very good possibility, slight, or somewhere in between?

Ms. STATHIS. I do not think that I can tell you from 1 percent to 100 percent what the odds are. I think that I can tell you that it only takes one bug in a system, depending on how significant it is, to cause lots of problems.

Mr. SCHULZE. Is there a method which you could use, a foolproof method, for testing that software so that the IRS can be assured that they will not have such problems?

Ms. STATHIS. I will ask Mr. Gonter to help me out here, but I do not know that anyone has ever said that testing is sure-proof; but obviously the more you test, the more you identify problems, and the more you work those out before you go on line, the safer you are going to be in running the system.

Mr. SCHULZE. So their biggest enemy is time?

Ms. STATHIS. The biggest enemy is time.

Mr. SCHULZE. You have touched on one of my concerns for quite some time, and that is adequate staffing and training of personnel. You noted IRS' inability to compete with the private sector in recruitment because the IRS does not give firm offers until after graduation. Are there students who would have chosen public service but did not want to wait or could not afford to pass up the offers from the private sector?

Ms. STATHIS. I do not know that I can tell you that for sure. I can surmise that the odds of getting those folks on board is very much enhanced if you are able to offer them a job at the time that that is very much on their minds. A job in hand would be worth a lot more than one that is potentially down the road.

Mr. SCHULZE. How large a factor is salary in that equation?

Ms. STATHIS. Given all that I read in the paper about today's college students' concern with financial security, I would guess that it has some bearing on it. The statistics that we have—and I do not have them readily at hand—show that the IRS salaries are not competitive with the "Big 8" accounting firms that are a major competitor for accountants, for example.

But they are not that far below what other accounting firms and private industry is paying entry-level accountants. So there is a

salary factor there but it is much less when you look at some of those other competitors.

Mr. SCHULZE. Are there other ways we could improve recruitment, perhaps hiring half of the requested authorized staffing level in the Spring?

Ms. STATHIS. I do not know what would be the best thing to do here. One possibility would be to try to provide the funds so that they are available in June for people to come on board at that time so that IRS knows in January that it can make firm offers to those people. I think that would very much enhance their recruiting efforts.

Mr. SCHULZE. I share your concern over seasonal employees and I am concerned about the trends we see in seasonal employees. Would it be wise to put more emphasis in converting seasonal employees to permanent employees?

Ms. STATHIS. That is one of the things we discuss in the statement as a potential way to help retain some of these people. I am told that the numbers of folks in our society who are willing to take seasonal jobs are much fewer now than they were at the time that some of the Service Centers were established, and that demographic condition affects the ability of the Service to hire these people.

Mr. SCHULZE. You do not have any quick fixes for that?

Ms. STATHIS. No. I do not think there are any quick fixes to any of this.

Mr. SCHULZE. GAO reported that its review of telephone assistance in 1986 showed that the IRS was incorrect in its response 22 percent of the time, incomplete 15 percent, and correct 63 percent of the time. What can they do or what can we do to help improve accuracy rates in taxpayer service?

Ms. STATHIS. There again, Mr. Schulze, you have a similar problem as the Service Center staffing problem. These are seasonal people and our figures showed that this year 30 percent of them were new. That means IRS has a mammoth task to train those people before the calls start coming in. So again, staffing patterns, recruiting, hiring, training are very critical functions there as well.

Mr. SCHULZE. Are they using the latest training methods—computerized training, and structured systems—or is it all classroom individual teachers? In your opinion are they doing everything they should do in order to train their personnel correctly?

Ms. STATHIS. Mr. Schulze, training is an area that we have looked at very little at the IRS, and I really cannot tell you the quality of the training provided. I do know that they provide five or six weeks of training for those people, which seems like quite a reasonable amount of time. But I cannot tell you anything about the specific methods or the quality of it.

Mr. SCHULZE. Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. Before you leave, Ms. Stathis, I want to ask Commissioner Gibbs to come forward if he would like to make any statement in response to the testimony. I assume you have either read or you have listened to the statements and her summary.

I am not trying to promote an argument, but there are some differences and if you would care to respond to it I would certainly be happy to hear from you.

Mr. GIBBS. Thank you, Mr. Chairman. I guess the best way I could respond on a constructive basis would be to say that I was pleased to hear Ms. Stathis really clarify basically what I think the report is intended to say to you and I would be happy to discuss individual items within the report but I read the report as saying that there are potential concerns in particular areas that GAO has.

I do not read the report to suggest—and perhaps I am wrong and if I am then perhaps we should have some further dialogue—but I do not read the report to say that GAO is questioning the viability of our budget and our revenue projections that we are making for 1988.

From that standpoint these are projections that the methodology for them, the basis for them and so forth has been accepted by Treasury, by the Congressional Budget Office. We have used them for years and I do not understand that that is what they are saying.

I also further understand that from the standpoint of some of the other issues, particularly with respect to implementation of tax reform, I understand that GAO is saying that there are potential issues and problems that could happen. We recognize that, and I see that they do as well.

At the present time we have an overall implementation plan for our activities. We have individual implementation plans for each of our functions and we are on target with those in terms of what we are doing. As I understood Ms. Stathis' testimony, I gather that that is also a place where we are in agreement.

With respect to the budget modeling, the season workforce issues, those types of things, I think we would have areas of some disagreement with GAO, but I do not know that it would be constructive to get into them today. I will just briefly mention that while I think it is important to take a look at the mix of seasonal workforce in the Centers and in taxpayer service, I would point out that we have reduced from 1986 to 1987 our seasonal workforce in the Centers from almost 17,000 down to almost 15,000.

Now, as we begin to take a look at that, there are some competing considerations that we feel very strongly urge caution in making a wholesale attempt to convert seasonals to permanent employees, not the least of which is the change that is going to be upcoming within the next several years in the foreseeable future in our technology. That may suggest that it is not appropriate from a budget, cost or other standpoint to convert seasonals.

Furthermore, with the quality projects that we have we have to be very, very careful when we bring people into the Centers to assume that because someone comes in in one area—for example, a transcriber—that we can after the filing system simply move them over into under-reporter. It may take very different skills.

It may take very different experience, and to assume that these people can simply be transferred from one area to the other without a further analysis we feel may be extremely inappropriate and unfair, really, to the people that we would be bringing aboard and the managers in the Centers.

With respect to our budget modeling, we have a model that we are using at the present time—and I noticed it was mentioned in the GAO report—that permits us with our compliance activities to

estimate what the marginal return on the dollar will be. There is a concern, I understand, that we do not include our collection or our accounts receivable in it. Plans are underway to include them but I would say this, I would say that we have used computer modeling for years.

This is a particular type of computer modeling that simply looks at all of the compliance functions across the board. It is quicker, it is easier to determine it, but we have been using computer modeling in the various areas and we can, in fact, and do take a look at what the marginal return would be in terms of where to put it.

Again, I think you have to be very, very careful in this area that you do not simply function on the marginal rate of return. If you did that it might suggest to you that you would put a lot more emphasis in a particular area to get dollars quicker; for example, accounts receivable, as I mentioned earlier in the testimony.

But we have to look at it from a tax administration standpoint on a very much more balanced basis of even though it might return you more money in the short run, if you do not have the proper balance between your compliance functions you may be sacrificing more in the long run. These are considerations that we bring to the computer modeling that we have done in the past and that we will do in the future.

Again, I am not sure that there are disagreements here. Perhaps there are differences in emphasis. Perhaps we really have not had the opportunity, given the short period of time, to sit down and have the exchange with the GAO about some of these issues, but they are things that I at least wanted to mention and I was delighted that Ms. Stathis did attempt to indicate that what they were really doing was looking at places in the future where there would be problems, as opposed to suggesting that there are problems or issues at the present time, if I understood her testimony correctly.

Chairman PICKLE. Well, thank you Commissioner. We have received your statement, and we have your full statement, Ms. Stathis.

As I read it you are making some very strong challenges to what the IRS had recommended and now the Commissioner says that he just really thought we had misunderstood each other. There is no spat going on at all here, that there is nothing to GAO's concerns and there is no real big difference.

I thought you were going to come roaring in here like a lion but you have gone out like a lamb, Commissioner. I do not believe that there is any real disagreement, so there is no family squabble and I guess we, the committee, then have just got to analyze what both of you have said and make our own recommendations.

I do not think I have any further comments to either one of you at this point.

Mr. GIBBS. Well, I would like to ask whether I understand——

Chairman PICKLE. I just assume you do not disagree with what she said, only with the emphasis or the intent.

Mr. GIBBS. I guess what I would ask is if my understanding is correct in terms of the areas that I summarized and basically what I have said. If I have misunderstood what the GAO is saying then perhaps we need some further discussion.

Chairman PICKLE. Well, you can read and you can hear and I just assume that you are saying that there is no real disagreement.

Ms. STATHIS. I agree with the Commissioner that he does have a correct understanding of the GAO statement.

Chairman PICKLE. Well, we should have had you all smoke this peace pipe, I guess a couple of days ago, and not have had this exchange.

Mr. Schulze?

Mr. SCHULZE. Mr. Chairman, I did not know that we are smoking peace pipes here, but I believe what we are doing is analyzing the ongoing operation of the IRS. None of us has a crystal ball that is totally clear and none of us can say what is going to happen. All we can do is give our best estimates.

I believe that the concurrence shows that we are heading in the right direction. I am pleased to see the agreement rather than seeing a great deal of contention. So I appreciate the testimony from both sides.

Chairman PICKLE. Let me ask one substantive question then with respect to the computer operations. We have heard and we are all in agreement, I assume, that the front-end processors are a serious problem in the whole ADP program as we look into the next year or two or three.

I am going to assume that it is in place and it is going forward, but what I also want to ask you is the IRS' tax system redesign going to stay on schedule next year? Who can respond to that?

Mr. GONTER. Mr. Pickle, while I can respond to your question I believe IRS is in the best position to answer you.

Based on the work that we have done, sir, IRS seems to be on schedule with its tax system redesign plans. As Mr. Gibbs' testimony indicates, by Spring of 1988 IRS intends to have some of the plans in place that are going to be essential to make the tax system redesign work.

I believe that because of all the attention being given to this subject during your subcommittee's hearings this year, IRS is staying on top of what they intend to do. However, we all have to wait and see if IRS will actually implement the redesign as currently planned.

Chairman PICKLE. Well, if it all goes well then we have a new system and we are in control of things. What would be the impact of further delays in case this test does not work out good in June?

Mr. GONTER. Now, when you say the test does not work out, are you talking about the front-end processor test or are you talking about the tax redesign, sir?

Chairman PICKLE. Well, now I am talking about the front-end processor primarily.

Mr. GONTER. About the front-end processor. Well, the current front-end processors, as Mr. Gibbs said, are working adequately at the present time. There have not been any major problems. It is difficult to predict how many problems they might have next year with the current front-end processors getting older. However, since the testing is progressing on the new front-end processors, as Mr. Gibbs has said, IRS expects the new front-end processors to provide relief for the old processors.

However, we all have to wait until June 15th to see the full test of the new front-end processors.

Chairman PICKLE. I do not think I am getting a response from you on the question I asked. Suppose that the test did not work out as we had hoped on June 15th?

Mr. GONTER. Yes, sir.

Chairman PICKLE. I am asking you what would be the impact of further delays, if we do not move forward with this? What would be the impact? Can you guess what difficulty we would be in if that were to happen?

Mr. GONTER. If the test failed in June—which we obviously all hope will not happen, and we believe that IRS has controls in place today to help ensure that that will not happen, or if they miss the 15th, they will not miss it by very much. The biggest impact for the future is that IRS needs these front-end processors so that it can add additional terminals for various applications that will be a part of the whole tax redesign effort.

So the biggest impact, given that the front-end processors that are in place today still operate successfully, is that IRS will not be able to install additional terminals in its Service Centers and district offices. We believe IRS would like to install these terminals as a part of system enhancements that it has planned for the future.

Chairman PICKLE. Well, I just assume that you are saying we should be watching it carefully and see what happens. What should we be watching for?

Mr. GONTER. We should be watching to make sure that IRS continues on the road that Mr. Gibbs has outlined at this point. Mr. Gibbs and his folks put together a very detailed information systems plan that lays out a lot of projects at IRS. Mr. Gibbs is trying to control all of those projects. He has people in place to do that.

Based on what we see today the actions that the Service is taking will enhance the ability to achieve the goals that they have set for themselves in the computer area.

Chairman PICKLE. Let me ask the Commissioner one other question. As I recall it, the 1988 budget which we have adopted shows that there will be a total additional revenue for 1988 over 1987 of about $40 billion. A good portion of that is due to beefing up in certain areas of personnel for IRS.

Do you agree that there will be about a $40 billion additional revenue by virtue of the budget you have advanced?

Mr. GIBBS. I think the figures that you are referring to are the total revenue that we anticipate collecting, from $800 billion in fiscal year 1987 to $840 billion in fiscal year 1988 that I testified to earlier.

The additional tax revenues that we will get from the additional compliance people are part of that figure and we believe that it will be collected.

We believe—based on the experience that we have had, for example, in our accounts receivable area—that the projections that we are making, if anything, will be low in the accounts receivable area. The reason we say that is because we believe the dollar value of the accounts receivable is going up, Mr. Pickle. Traditionally, when you look at the last several years, if anything, we have been

beneath what we have projected we will produce in terms of our enforcement programs.

Chairman PICKLE. Did you, sir, want to add something to it or are you just anxious to lend your support by nodding?

Mr. TAYLOR. Mr. Chairman, as the Commissioner has pointed out, we have as an agency tended to be conservative in our projections of the revenue effect of our programs.

Chairman PICKLE. All right. If then you are conservative, we can say that that $40 billion of extra revenue is real money and it should not be questioned but accepted.

Mr. GIBBS. Mr. Chairman, we believe so, and we believe that is borne out by past experience and also by the fact that it is not just the Internal Revenue Service that is saying that. That is something where we have had to go to the Treasury Department, and we have had to go to OMB, and we have had to go to the Congressional Budget Office and chat with each of those folks about our revenue projections from direct tax enforcement. Also included in the overall estimates are projections made by the Treasury Department reflecting economic conditions.

Chairman PICKLE. We hope you are correct. In the supplemental bill, which is up now you are asking for $200 million more, both for tax reform and for taxpayer services. I think that is a reasonable request and at some time during the day we hope that will be included in the bill.

I am personally pleased to see that you feel that that $40 billion additional revenue for 1988 is a real figure and that it should be accepted by the Congress.

All right, I thank you.

We have questions to submit to the Commissioner.

[The questions and answers follow:]

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COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC 20515

SUBCOMMITTEE ON OVERSIGHT

April 23, 1987

The Honorable Lawrence B. Gibbs
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Commissioner Gibbs:

In order to complete the record on today's Subcommittee on Oversight hearing on the Administration's Fiscal Year 1988 budget proposals relating to the Internal Revenue Service, please respond to the following questions.

1. The IRS sent a budget request to Treasury for 119,630 staff positions and $5.8 billion. The budget OMB submitted to the Congress requests 9,000 less positions and $724 million less in funding.

   (a) What happened?

   (b) Why did you think you needed 9,000 more positions and $724 million more in funding?

   (c) What activities will you not do under OMB's budget which you would have done under yours?

   (d) How much revenue could be brought in under your (IRS) proposal that will not be brought in under OMB's proposal?

2. How would the Service allocate additional staffing over the proposed FY 1988 levels at each of the following levels:

   (a) 500 additonal staff?

   (b) 1,500 additional staff?

   (c) 3,500 additional staff?

   (d) 5,000 additional staff?

(e) What would the yield-to-cost ratio be at each level?

3. Has the IRS needed to shift resources since submission of the budget which would create or indicate a problem for next year that the FY '88 budget request does not address?

4. Both IRS and Treasury had requested close to 300 more positions for Executive Direction and Management Services than OMB proposed in the FY '88 Budget.

   (a) What is the impact of 487 fewer positions in FY '88 than in 1986?

   (b) Where were those positions needed?

5. Although OMB's budget request increases the number of positions in Returns Processing and Computer Services, IRS had requested from Treasury double that additional number of positions [FY '87 - 30,629 positions; FY '88 request - IRS to Treasury: 37,605 positions and OMB to Congress: 33,300 positions]

   (a) For what purposes did you request 7,000 more employees for FY '88 than authorized for FY '87?

   (b) IRS projects 4.3 million additional returns in 1988. Will 2,030 new positions accomodate those additional returns? What is the maximum number of additional returns and supplemental documents possible next year and is this staff sufficient to respond?

6. Along with the need for the sheer number of employees, there are serious questions about the training of returns processing personnel.

   (a) Are you satisfied with the current training programs?

   (b) If not, how are you improving the training of personnel to ensure fewer errors?

   (c) Does the budget proposal allow the resources to improve in this area?

7. One of the more important steps that IRS must take in implementing the Tax Reform Act is to revise many of the computer programs used in processing tax returns. In addition, IRS must have the right amount of computer support ready and available to handle the processing of tax returns and to respond in an efficient manner to taxpayer inquiries.

   (a) How long and complex is the task of rewriting your computer programs to accommodate the changes required by the Tax Reform Act? In other words, will you have to change 10, 15, 25 percent of the code in these programs? Also, how much staff resources -- in terms of staff years or dollars -- do you expect you will spend to change and test these programs?

   (b) Do you have the necessary time to rewrite the programs and adequately test them before they go into operation in January 1988?

   (c) What other kinds of changes are going to be made to IRS' computer operations in implementing the Tax Reform Act?

   (d) What impact will these changes have on the processing power of your computers? Will your computers meet your processing needs in 1988?

   (e) Given the level of effort necessary to implement the Tax Reform Act, will you have to cut back in any other areas? If so, what areas will be affected and to what degree?

8. Looking at the trend in your examination policy over the past few years, there has been a steady decline in the percentage of returns audited from 2.11 percent in FY 1980 to the 1.12 percent for FY 1986. FY 1987 coverage rose to only 1.44% the estimated FY '88 audit rate is 1.61%, still 25% lower (.5%) than the 1980 rate.

   (c) What is the maximum number of examination staff the IRS could absorb (hire and fully train) in one year?

   (d) What returns will be audited under the proposed 1.61% rate for FY 1988 (breakdown by individuals, corporate; breakdown by income class, size)?

   (e) Can the IRS absorb effectively and productively additional staff in FY 1988?

9. The estimated inventory of Tax Litigation continues to climb in FY '88 even with additional positions.

   (a) To what do you attribute the increase?

   (b) Is the impact of the increased focus on Collection in FY '88 included in your inventory estimates?

10. To what do you attribute the continuing decline in the audit rate for exempt organizations, which would fall to a new all-time low of 1.55%?

11. With regard to Employee Plans and Exempt Organizations, what activities would be conducted under the budget amounts IRS requested but were not included in the proposed budget?

12. How many staff does IRS need to appropriately assist taxpayers?

13. Your budget submission to Treasury requested 1,698 more positions for Taxpayer Service than OMB included in the Congressional submission.

    What activities will IRS forego because OMB did not give IRS what it requested for FY 1988?

14. Of the calls the IRS received at the end of March, 1987, 16.8% pertained to tax reform and 3.7% pertained to the W-4 Form. Won't there be even more questions about tax reform next year? How is the proposed cut in taxpayer service justified?

15. How many staff would you need in FY 1988 to achieve an 80% level of service? 85% level of service?

I appreciate your prompt attention to this request. I consider this matter to be a priority item. A response must be received no later than close of business Wednesday, April 29, 1987.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/rgw

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

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APR 30 1987
Ways and Means
Subcommittee on Oversight

The Honorable J. [illegible]
Chairman, Subcommittee on Oversight
House Committee on Ways and Means
1105 Longworth Building
Washington, DC 20515

Dear Mr. Chairman:

I have enclosed replies to the fifteen questions posed in your April 23 letter to the Commissioner, which completes the record from your hearing on the Service's FY 1988 budget.

We appreciated the opportunity to discuss this important subject with you and the Members of the Subcommittee.

With kind regards, I am

Sincerely,

Bryan Stone
Assistant to the Commissioner
(Legislative Liaison)

Enclosures

1. The IRS sent a budget request to Treasury for 119,630 staff positions and $5.8 billion. The budget OMB submitted to the Congress requests 9,000 fewer positions and $724 million less funding.

(a) What happened?

In the budget review process the IRS FY 1988 request was scaled back by 9,000 positions and $724 million. The Budget as proposed to Congress nevertheless represents an increase of 9,463 positions and $624 million for a total of 110,661 average positions and $5.1 billion.

(b) Why did you think you needed 9,000 more positions and $724 million more funding?

The Service had requested the additional positions to further expand and improve operations in most IRS activities.

(c) What activities will you not do under OMB's budget which you would have done under yours?

Overall the Administration (Treasury and OMB) met 93% of staffing requested and 88% of the funds requested by IRS for 1988. Most revenue-producing programs, including new revenue initiatives were approved. This reflects the Administration's objective to meet deficit reduction targets without raising taxes. The Administration also provided additional resources to cover pay and other mandatory costs. The Service is, however, absorbing $159 million for employee retirement and inflationary costs. Increases for some programs could not be met within overall budget constraints. Included are:

- Taxpayer Service - IRS requested resources to achieve an 85% level of telephone service. The Administration did not provide additional resources for this purpose, continuing the lower level (65%) authorized under the continuing resolution for 1987. Resources were provided to implement tax reform.

- Returns Processing - IRS requested additional resources to improve quality and undertake new initiatives to advise taxpayers of errors. These initiatives were not approved. The Administration did approve additional resources to implement tax reform and process 4.3 million more tax returns.

- Tax Fraud - IRS requested additional staff to increase its general enforcement program. The Administration did not approve the increase. It did, however, retain the additional resources (100 positions) added in 1987 for drug enforcement (i.e. Project Alliance).

(d) How much revenue could be brought in under your (IRS) proposal that will not be brought in under OMB's proposal?

The IRS FY 1988 budget as proposed to OMB would have brought in $50.0 billion from direct enforcement of the tax laws (i.e. examination, collection, document matching). The budget as approved by the Administration will produce $49.4 billion.

Question: How would the Service allocate additional staffing over the proposed FY 1988 levels at each of the following levels:

(a) 500 additional staff
(b) 1,500 additional staff
(c) 3,500 additional staff
(d) 5,000 additional staff

Answer: On April 2, the Service submitted to the House Committee on Appropriations a Five Year Resource Plan (copy enclosed). This plan was prepared at the Committee's request. On page 14 of the plan the Service has identified how it would deploy additional staffing in FY 1988 and future years.

In FY 1988, the Service could deploy an additional 2,295 positions over the increased staffing levels requested in the President's budget now pending before the Congress. The first 500 positions would be allocated to improve taxpayer service by increasing the level of telephone service. The next 1,000 positions would be devoted to (a) taxpayer service (625 positions) and (b) taxpayer correspondence (341 positions). The remaining 829 positions would be used to address special compliance concerns, specifically overseas investigations of tax havens (585 positions), tax fraud (108 positions), audit employee plans (84 positions), provide for improved internal security (27 positions) and internal audit (25 positions).

Summary

Program	Positions	Cost ($000)
Taxpayer Service	500	$ 21.4
Taxpayer Service	625	$ 26.7
Subtotal	1,125	$ 48.1
Taxpayer Correspondence	341	$ 9.7
Subtotal	1,466	$ 57.8
Overseas Tax Havens	585	$ 32.8
Tax Fraud Investigations	108	$ 6.1
Employee Plans	84	$ 3.1
Internal Security	27	$ 1.5
Internal Audit	25	$ 1.2
Total	2,295	$102.5

3. Has the IRS needed to shift resources since submission of the budget which would create or indicate a problem for next year that the FY 88 budget request does not address?

During the FY 1987 filing season, the Service redirected resources to ensure a smooth and efficient filing season. To continue the quality improvements begun in FY 1986 in our tax processing function, over 2,500 average positions have been redirected into our service centers to ensure that returns were processed accurately and refunds issued timely. The Service has also redirected 500 additional positions into taxpayer service in FY 87, which will enable us to assist 4.85 million more taxpayers.

In our FY 88 budget, the Service is requesting to transfer resources up to five percent, among our four operating appropriations. With the need to absorb almost $160 million in cost increases, implement tax reform and ensure an efficient filing season, it is important that the Service be granted this transfer authority.

4. Both IRS and Treasury had requested close to 300 more positions for Executive Direction and Management Services than OMB proposed in the FY 88 Budget. What is the impact of 487 fewer positions in FY 1988 than in FY 1986? Where were those positions needed?

The decrease of 487 average positions between FY 88 and FY 86 is due to (1) a realignment of program responsibilities and costs (414 average positions) and (2) budget reductions, to help offset uncontrollable cost increases (73 average positions). In keeping with the need to assign costs to those activities which directly benefit, the costs of payroll operations are now charged to each benefitting appropriation and budget activity.

Question 5a: For what purpose did you request 7,000 more employees for FY 1988 than authorized for FY 1987?

Answer: The Service requested an additional 5,420 positions for the Returns Processing and Revenue Accounting activity. This increase included approximately 2,900 positions for FY 1987, alone, to cover service center base deficiencies as well as a request for a net 1988 increase of 2,520 positions. Included in this latter figure was a 1,050 position request for implementing the Tax Reform Act of 1986 (P.L. 99-514). The Tax Reform positions were subsequently approved. Final approval of the additional positions for FY 1988 increases was constrained to principally workload growth to process additional returns (756 average positions), statistics of income sampling (39 average positions), and the information returns matching initiative, (1,000 average positions). Positions to accomplish taxpayer correspondence work were disallowed (317 average positions).

Computer Services also requested an additional 1,556 positions in FY 1988 for various projects. For example, 745 positions were requested to automate the examination process and integrate existing systems; 437 positions were requested to provide around-the-clock work shifts at the service centers and to provide for capacity planning, systems integration and user assistance; and 244 additional positions to support the goal of long-term redesign of the tax processing system and to provide capability for taxpayers to file returns electronically through automated return preparers.

Question 5b: IRS projects 4.3 million additional returns in 1988. Will 2,030 new positions accommodate those additional returns? What is the maximum number of additional returns and supplemental documents possible next year and is this staff sufficient to respond?

Answer: The 2,030 new positions requested principally represent additional positions to match information returns for income/credit deduction discrepancies (1,317 average positions) and to process the projected 4.3 million additional returns and 800,000 more supplemental documents (756 average positions). If these resources to process additional returns should prove inadequate, the Service will reassess its needs with the Treasury Department.

6(a). Along with the need for the sheer number of employees, there are serious questions about the training of returns processing personnel.

Are you satisfied with the current training programs?

Yes.

As of mid-April 1987, for our major individual tax returns programs, error rates and production rates have improved over the 1986 experience for the same period. This result is satisfying but there is continuing need and opportunity for improvement.

6(b). Along with the need for the sheer number of employees, there are serious questions about the training of returns processing personnel.

If not, how are you improving the training of personnel to ensure fewer errors?

Improvement of quality necessarily goes beyond basic skill training. For instance, our Quality Assurance Program along with the tax processing system identifies those items on tax returns that are contrary to prescribed tax processing requirements. Each does its part to ensure that the product that is produced has adhered to proper levels of mathematical correctness and has followed set procedural requirements.

The efforts on quality improvement provide for ongoing feedback on products, a pro-quality environment and input to our general training programs.

Maintaining the current level of training will continue to improve quality in all areas of service center operations. With the increased emphasis on quality, it is essential that the current level of training be continued to ensure that employees can do their jobs correctly the first time. Taxpayer relations should show positive results.

6.(c)
Along with the need for the sheer number of employees, there are serious questions about the training of returns processing personnel.

Does the budget proposal allow the resources to improve in this area?

Answer:

In the past two years (1986 and 1987), the Service has improved the training given its employees in the ten service centers. This has helped ensure accurate tax processing and timely issuing of refunds. The budget proposed for next year (1988) contains additional resources to train employees on tax reform.

7. (a) How long and complex is the task of rewriting your computer programs to accommodate the changes required by the Tax Reform Act? In other words, will you have to change 10, 15, 25 percent of the code in these programs? Also, how much staff resources -- in terms of staff years or dollars -- do you expect you will spend to change and test these programs?

Response:

Although it is still early in the program redesign stage and we are not yet into modifying actual lines of code, we estimate that approximately 20-25 per cent of the code will be modified as a result of the Tax Reform Act.

We anticipate that in FY 1987, 182 staff years will be devoted to program changes and testing related to those aspects of the Tax Reform Act which must be implemented for Tax Year 1987.

7. (b) Do you have the necessary time to rewrite the programs and adequately test them before they go into operation in January 1988?

Response:

Yes. All of the Tax Reform Act changes which were deemed an appropriate application for our automated systems will be tested and implemented in 1988. Concurrent with passage of the Tax Reform Act, we began development of an implementation plan to identify each action that the Service needed to take in order to implement the many changes required. In addition, an Executive Steering Group was established by the Commissioner to monitor the timeliness of all phases and aspects of our implementation plan and to identify and resolve problems/issues.

7. (c) What other kinds of changes are going to be made to IRS' computer operations in implementing the Tax Reform Act?

Response:

Additional key entry requirements will be met by the addition of ten (10) Distributed Input System (DIS) nodes in FY 1988 to accommodate Tax Reform Act changes relating to identification of social security numbers for dependents claimed on tax returns and the taxation of minors.

7. (d) What impact will these changes have on the processing power of your computers? Will your computers meet your processing needs in 1988?

Response:

Implementing the Tax Reform Act will not radically change actual computer processing time but rather the manner in which the data is manipulated. Although program code changes are required, once past the key entry process the impact on the processing power of our computers will be accommodated with our existing equipment.

Yes, the UNISYS mainframe computers will meet our processing needs in 1988. As discussed in our response to question #7. (C), with the addition of ten (10) DIS nodes our key entry systems will also meet our needs in 1988.

7. (e) Given the level of effort necessary to implement the Tax Reform Act, will you have to cut back in any other areas? If so, what areas will be affected and to what degree?

While our attention has been focused on implementing the Tax Reform Act, this has not been totally at the exclusion of routine maintenance and enhancement type changes. Some changes which are not critical to tax processing and have minimal impact for FY 1988 will not be implemented.

EXAMINATION COVERAGE

Looking at the trend in your examination policy over the past few years, there has been a steady decline in the percentage of returns audited from 2.11 percent in FY 1980 to the 1.12 percent for FY 1986. FY 1987 coverage rose to only 1.44% the estimated FY '88 audit rate is 1.61%, still 25% lower (.5%) than the 1980 rate.

(c) What is the maximum number of examination staff the IRS could absorb (hire and fully train) in one year?

The maximum number of Examination staff that IRS can assimilate (recruit, train, and deploy) in one year is 2,500 personnel.

(d) What returns will be audited under the proposed 1.61% rate for FY 1988 (breakdown by individuals, corporate; breakdown by income class, size)?

I submit, for the record, a chart showing planned examinations by class of tax return for FY 1988 which will achieve a coverage rate of 1.61%.

(e) Can the IRS absorb effectively and productively additional staff in FY 1988?

Yes, IRS can effectively and productively absorb the proposed 2,500 additional staff in FY 1988.

FY 1988 BUDGET
PLANNED EXAMINATIONS BY CATEGORY

	CLASS NAME	PLANNED EXAMINATIONS	PERCENT COVERAGE
	INDIVIDUALS		
1	UNDER $10,000 1040A TYPE	107,992	0.60
2	NON 1040A TYPE	60,252	0.57
	$10,000-$25,000		
3	SIMPLE	268,386	1.21
4	COMPLEX	107,102	1.02
5	$25,000-$50,000	362,060	1.37
6	$50,000 AND OVER	300,060	2.51
	BUSINESS (TOTAL GROSS RECEIPTS)		
7	-C- UNDER $25,000	35,162	1.90
8	-C- $25,000-$100,000	54,947	2.48
9	-C- $100,000 AND OVER	68,856	5.73
10	-F- UNDER $25,000	10,099	4.53
11	-F- $25,000-$100,000	7,770	2.00
12	-F- $100,000 AND OVER	14,669	7.51
	TOTAL INDIVIDUALS	1,397,355	1.32
	CORPORATIONS		
16	NO BALANCE SHEET	2,835	1.45
17	UNDER $50,000	7,129	0.83
18	$50,000-$100,000	4,749	1.21
19	$100,000-$250,000	4,673	0.88
20	$250,000-$500,000	3,582	1.11
21	$500,000-$1 MIL.	7,479	3.41
22	$1 MIL.-$5 MIL.	16,457	7.75
23	$5 MIL.-$10 MIL.	6,018	19.86
24	$10 MIL.-$50 MIL.	3,742	11.31
25	$50 MIL.-$100 MIL.	4,058	56.70
26	$100 MIL. AND OVER	5,452	56.98
	TOTAL CORPORATIONS	66,174	2.35
31	TAX SHELTER INVESTORS	267,851	0.00
32	FIDUCIARY	7,214	0.32
33	PARTNERSHIP	14,803	0.81
34	1120S	13,158	1.64
35	CLAIMS	60,888	2.99
36	TAX PROTESTERS	14,637	0.00
37	SEP	3,129	0.00
38	PROMOTER TAX SHELTERS	1	0.00
	ESTATE		
39	UNDER $1 MIL.	2,278	6.74
40	$1 MIL.-$5 MIL.	7,423	49.49
41	$5 MIL. AND OVER	564	43.69
	TOTAL ESTATE	10,265	20.49
42	GIFT	1,560	1.37
	TOTAL INCOME,FID.,ESTATE, ...GIFT,1065&1120S	1,857,035	1.61

9. The estimated inventory of Tax Litigation continues to climb in FY 88 even with additional positions.

(a) To what do you attribute the increase?

Tax Shelters cases account for the majority of the increase in cases in litigation as Examination continues to move the existing inventory. There are still 420,000 plus return years in Examination. In addition, the increasing inventory probably reflects the increasingly litigious nature of American society.

(b) Is the impact of the increased focus on Collection in FY 88 included in your inventory estimates?

No. Increased focus on collection would probably have little or no impact on Tax Court inventory because the Tax Court is a prepayment forum where the taxpayer can litigate his case first and pay, if he loses, later. The vast majority of all disputed tax cases go through the Tax Court.

To what do you attribute the continuing decline in the audit rate for exempt organizations, which would fall to a new all-time low of 1.55%?

We have begun to compute our examination coverage rate in a new manner. We now compute the percentage by dividing the number of returns examined by the number of returns filed. Previously, we divided the number of exempt entities examined by the total number of entities in existence. Our most recent projected exempt organizations examination coverage rate for FY 1988 is 4.74%, which is based upon examining 20,200 returns. This compares with 19,600 returns examined in FY 1986 and 21,837 in FY 1987. Accordingly, the FY 1988 exempt organizations examination program will be similar breadth as in the recent past.

The number of examinations conducted each year fluctuates somewhat because we must also utilize our exempt organizations resources to issue determination letters in response to applications for approval of tax exempt status. In general, as receipts of applications have gradually increased, examination resources have been diverted to the determination letter program, and the number of examinations conducted has decreased. Additionally, the number of returns filed fluctuates somewhat, although there has been gradual upward trend. These two factors, the gradual diversion of examination resource to the determination program and the increase in the number of returns filed, have gradually lowered the exempt organizations examination coverage rate.

With regard to Employee Plans and Exempt Organizations, what activities would be conducted under the budget amounts IRS requested but were not included in the proposed budget?

Actually, owing to the resources being requested to implement the Tax Reform Act of 1986, Employee Plans and Exempt Organizations current proposed budget for FY 1988 provides for a higher level of resources than was originally requested by IRS last summer.

The additional resources now in the proposed budget are needed to review an estimated 665,000 pension plans amendments that will be sent to the IRS with applications for determination letters ruling that the plans are in conformance with the Tax Reform Act. The resources are also needed to conduct additional examinations of the returns of employee plans. This additional examination presence is needed to enforce the new and extended excise taxes imposed by the Tax Reform Act.

· Question: How many staff does IRS need to appropriately assist taxpayers?

Answer: The Service believes that an 85% level of telephone service is the optimal balance point between service to the public and efficient use of telephone circuitry and personnel; it means answering 85 percent of the callers attempting to access our toll-free telephone system on a weekly basis. Preliminary estimates indicate that increasing telephone service to an 85 level will require 1,125 additional average positions above the President's FY 1988 budget. This need, however, is subject to changes in the unit-per-staff-hour rates used to compute Taxpayer Service staffing requirements and the number of telephone calls expected from taxpayers in 1988.

· Question : Your budget submission to Treasury requested 1,698 more positions for Taxpayer Service than OMB included in the Congressional submission. What activities will IRS forego because OMB did not give IRS what it requested for FY 1988?

Answer: Taxpayer Service's average position availability determines the number of telephone calls it can answer each year; simply stated, fewer average positions mean fewer calls answered. For the past two years, the Service has redirected resources from other functions to Taxpayer Service to ensure the delivery of a minimally acceptable level of telephone service.

· Question: Of the calls the IRS received at the end of March 1987, 16.8% pertained to tax reform and 3.7% pertained to the W-4 Form. Won't there be even more questions about tax reform next year? How is the proposed cut in taxpayer service justified?

Answer: In FY 1987, Taxpayer Service estimated that it would receive an additional 3.8 million telephone calls on the Tax Reform Act of 1986; in FY 1988, it expects an additional 2.4 million calls. Taxpayer Service is projecting less of an increase in the overall demand for service next year in large measure because the new rules surrounding Form W-4 should cease to be an issue after October 1, 1987. Of the estimated 3.8 million tax reform-related calls in FY 1987, we projected that 1.6 million would deal with the new withholding provisions.

· Question: How many staff would you need in FY 1988 to achieve an 80% level of service? 85% level of service?

Answer: In FY 1988 Taxpayer Service needs an additional 865 average positions to achieve an 80% level of telephone service; it needs an additional 1,125 average positions to achieve an 85% level. Both figures, however, are subject to changes in the unit-per-staff-hour rates used to compute Taxpayer Service staffing requirements and the number of telephone calls expected from taxpayers in 1988.

J.J. PICKLE, TEXAS, CHAIRMAN
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RAYMOND J. McGRATH, NEW YORK

Ex Officio:
DAN ROSTENKOWSKI, ILLINOIS
JOHN J. DUNCAN, TENNESSEE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515
SUBCOMMITTEE ON OVERSIGHT

April 29, 1987

Hubiratie

DAN ROSTENKOWSKI, ILLINOIS, CHAIRMAN
COMMITTEE ON WAYS AND MEANS

JOSEPH S. DOWLEY, CHIEF COUNSEL
BETH KENTE HANCE, SUBCOMMITTEE STAFF DIRECTOR

A.L. SINGLETON, MINORITY CHIEF OF STAFF
MICHAEL A. SUPERATA, COUNSEL TO THE MINORITY

The Honorable Lawrence B. Gibbs
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Commissioner Gibbs:

In order to complete the record on the segment of the Subcommittee on Oversight's April 23, 1987 hearing on the ability of the Internal Revenue Service and the Tax Court to reduce the backlog of pending Tax Court cases, please respond to the following questions.

1. The Tax Court recently began a new procedure to calendar cases for trial. Under this new procedure, dockets are organized by place of trial and assigned, oldest docket first, for trial on a first-in-first-out ("FIFO") basis. Also, calendars are issued five months in advance of the trial session, instead of the previous three months.

   a. Is this new "FIFO" calendaring procedure helping to reduce the backlog of cases pending in the Tax Court? If so, how?

   b. What have you done to implement this new procedure?

   c. In your opinion, could the new procedure be improved? If so, how?

2. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) created new "unified" procedures for partnership examinations under which the audit (and any resulting adjustments or litigation) of partnership items is to be conducted in a single proceeding at the partnership level.

   a. Are these "unified" procedures adequate?

   b. Is further legislative change needed to reduce the number of individuals that are currently required to participate in the partnership examinations under the procedure?

3. In July 1986, the GAO recommended that the IRS Commissioner revise the language of the 30-day letter (preliminary notice before a notice of deficiency is sent the taxpayer), various IRS publications, and the information on the appeal procedures given to taxpayers by IRS auditors and revenue agents. The suggested revision would emphasize the advantages of going to the Appeals Division before filing with the Tax Court, and would point out that even if taxpayers bypass Appeals, the cases will still be assigned to Appeals for attempted settlement.

   a. Has the IRS revised these various documents and publications to point out the benefits to taxpayers of going to Appeals first? If not, why not?

   b. The total number of cases that bypassed the Appeals Division and filed directly with the Tax Court increased 62% from 1983 to 1986. Can you recommend improvements in IRS procedures that would encourage more taxpayers to request an Appeals conference before petitioning the Tax Court?

4. Is the IRS being timely notified of petition filings so as to prevent "premature" assessments?

I appreciate your prompt attention to this request. Please provide a response by May 22, 1987.

In addition, please provide me with a report, by June 30, 1987, listing all the law schools at which students were recruited by the Office of Chief Counsel and the Regional Counsel Offices during calendar year 1986 and the first three months of calendar year 1987. The reports should list, by IRS region, the schools visited, when they were visited, the number of offers made and the dates of the offers, the number of acceptances, and the reporting dates of those accepting the offers.

If you have any questions concerning this letter, please contact the Subcommittee staff at 225-5522.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tml

CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

May 27, 1987

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JUN 8 1987
Ways and Means
Subcommittee on Oversight

The Honorable J. J. Pickle
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Pickle:

This is in response to your letter of April 29, 1987, to Commissioner Gibbs requesting answers to additional questions regarding the ability of the Internal Revenue Service and the Tax Court to reduce the backlog of pending Tax Court cases.

FIRST IN - FIRST OUT CALENDARING PROCESS

a) Effect on Dispositions

As I stated in my testimony on April 23, 1987, before your subcommittee, disposals for the first six months of FY 1987 have increased 16% over those for the first six months of FY 1986. We believe this increase in disposals is attributable, in part, to the new "first in - first out" (FIFO) calendaring process pursuant to which significantly more cases were calendared during the winter 1987 term than during the winter 1986 term.

Our experience is that calendaring a case for trial is the greatest impetus to settlement of a docketed case. Calendaring more cases for trial will result in more dispositions. We do not believe, however, that FIFO calendaring is the only thing that will help to reduce the backlog of pending Tax Court cases. The shelter project approach, under which related tax shelter cases are grouped together, provides an efficient means to resolve large blocks of cases. Aggressive management of these projects by our project attorneys and by Tax Court judges is also helping to reduce the Tax Court backlog.

b) Service Implementation of FIFO Calendaring

We have taken a number of steps to ensure that the FIFO calendaring procedure is successful. First, as soon as the Tax Court Schedule of Sessions is released for a particular term, usually about six months prior to the commencement of the term, the schedule is disseminated to all district counsel and regional counsel offices so that they can begin preparation for the coming calendars. Local offices are then able to obtain a "Trial Calendar Listing Report" from our computerized case tracking system. This report lists, in docket number order, all cases that have not yet been tried or settled, except for shelter project cases. (Shelter project cases are excluded from the report because they are not normally included in the FIFO calendaring process; rather, projects are generally assigned

directly to judges who determine the schedule for trial). The district counsel offices are then able to use the report to predict which cases will appear on calendars and coordinate early settlement negotiations by our appeals officers and early trial preparation by our attorneys, as appropriate.

Second, because shelter project cases involving many petitioners with the same issue can be more efficiently litigated or settled as a group assigned to a single judge, placing them on FIFO calendars is a missed opportunity to calendar and dispose of other, non-project cases. When shelter project cases appear on regular calendars, they are almost always continued from that session. Steps have been taken to make it less likely that shelter project cases will be inadvertently calendared on FIFO calendars. We periodically supply the Tax Court with a list from our computerized case tracking system of the names and docket numbers of cases we have identified as belonging in tax shelter projects. This list is one way the Tax Court knows which cases are shelter project cases to be assigned to judges rather than placed on FIFO calendars.

c) Suggestions for Improvement

Although the FIFO calendaring is relatively new, we have some suggestions for improving dispositions. First, we favor increasing the number of back-to-back Tax Court sessions whereby judges are sent to the same place of trial two to three times for consecutive calendars. This allows judges to maintain stricter control of cases and, under appropriate circumstances, to grant continuances from or to hear motions during the first calendar and then return for a trial of the case at the follow-up calendar. These back-to-back calendars are particularly helpful in larger cities which have frequent calendars. Expansion of this program to include smaller cities, by scheduling back-to-back one-week sessions (instead of two-week sessions) 30 days apart, should be considered.

Second, in order to make it more likely that a case will be disposed of the first time it is calendared, pretrial involvement by judges in discovery disputes and the stipulation process should be increased through, among other things, informal pretrial conferences well in advance of the calendar.

TEFRA PARTNERSHIPS

In your letter dated April 29, 1987, you asked whether the TEFRA partnership procedures are adequate and whether further legislative change is needed to reduce the number of individuals that are required to participate in the partnership-level

procedures. Experience with TEFRA partnership provisions during the past several years has resulted in a growing awareness of the administrative complexity attendant to these procedures. It is appropriate to balance the advantages of unified administrative and litigation proceedings against the need for reasonably straight-forward procedures. The Service developed a project approach to the handling of pre-TEFRA cases and in the process ameliorated many of the logistical problems that gave rise to the TEFRA partnership audit provisions.

We are increasingly concerned that TEFRA's administrative complexity may not be warranted for either small partnerships or S corporations, especially in view of recent tax legislation which is intended to reduce the use of these entities as investment vehicles. In the coming months, we will study the TEFRA procedures and, in conjunction with the Treasury Department, explore possible procedural modifications. Limitations on the scope of TEFRA procedures will also be studied. Additional time is required to develop and evaluate possible legislative proposals and we expect to provide you with the results of our analysis within 90 days.

APPEALS BYPASS

In November 1986, the Service revised Publication 556, "Examination of Returns, Appeal Rights, and Claims for Refund." The new publication explains that even if a taxpayer bypasses Appeals during the administrative process, a docketed Tax Court case is normally considered for settlement by an Appeals Officer before the case is tried. Publication 556 also states that Appeals is independent of the District Director. Similar changes are currently being made to 30-day letters issued by Examination and to Publication 5, Appeals Rights and Preparation of Protests for Unagreed Cases, which accompanies the 30-day letter. We are also considering changes to the 30-day letter to advise taxpayers of the Tax Court's new authority under section 6673 to award damages against taxpayers who unreasonably fail to pursue available administrative remedies to resolve their cases prior to filing a Tax Court petition.

We believe these changes will encourage more taxpayers to request an Appeals conference. We can also help achieve this result by making it easier for taxpayers to request such a conference, especially in cases involving moderate amounts of tax. We are therefore considering a change to the procedural regulations to require only a brief statement of disputed issues (as opposed to a formal protest) for field examination cases involving additional tax of more than $2,500 but less than $10,000 for any taxable period. In field examination cases of $2,500 or less and in all office or correspondence examination cases, Appeals consideration will continue to be available upon request (either oral or written).

TIMELY NOTICE OF PETITIONS TO PREVENT PREMATURE ASSESSMENTS

a) General Background

Under section 6213(a), the Service is prohibited from assessing tax during the time when a Tax Court petition may be filed and, if a petition is filed, until the Court's decision becomes final. Under section 6503(a)(1), the statute of limitations on assessment is suspended during the time for filing a Tax Court petition and, if a petition is not filed, for 60 days thereafter. If a petition is not filed, the interplay between these two provisions often gives the Service only a 60-day "window" during which to assess the tax. The Service's practice is to wait 30 days after the end of the Tax Court filing period before beginning the assessment process. It is thus essential that field offices learn of new Tax Court petitions during this 30 day period and stop the assessment process before it begins. If a Tax Court petition has been filed, the failure to stop the assessment process results in a "premature assessment," a violation of section 6213(a).

During a portion of each year (May to September), the volume of Tax Court petitions increases dramatically. This increased volume places great stress upon the Service's ability to process petitions and stop premature assessments. The same is true for the U.S. Tax Court. The Court's processing time for new petitions fluctuates between two and six calendar days for most of the year. During the peak Tax Court filing season, however, the Court's average processing time can increase to an average of 16 calendar days, thus making it difficult to avoid premature assessments.

b) Processing by the Service

To reduce the likelihood of improper assessments, Tax Litigation Division now processes the daily petitions on micro-computers as well as the mainframe case tracking system. By electronically transmitting this list to distant regions, copying and mailing times are eliminated, and regional offices have more time to stop the assessment process. Additionally, the new micro-computer process provides the list in a format which can be used to automatically compare petitions to lists of statutory notices that have been issued, thus enabling the Service to prevent an assessment even after the assessment process begins. In one region, the electronic transmission process was largely responsible for a 97% reduction in the number of improper assessments. In regions where electronic transmission is not yet possible, express mail is used for the daily docket list during the peak filing season.

Because of the success of the electronic transmission project, it has been expanded to a second region, a third region is developing the capacity, and the Austin Service Center will use it during the 1987 peak filing season. The system is in the process of being implemented nationwide.

c) Suggestion for Possible Improvements

We believe that the nationwide expansion of the electronic transmission of petition information will substantially reduce premature assessments. Reduction of the Tax Court processing times during the peak periods will also have a significant impact.

Sincerely yours,

William F. Nelson

WILLIAM F. NELSON
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CHIEF COUNSEL

JUL 2 1987

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JUL 6 1987
Ways and Means
Subcommittee on Oversight

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House of Representatives
Washington, D.C. 20515

Dear Mr. Pickle:

In response to your April 29, 1987, letter to Commissioner Gibbs, which in part requested information regarding Office of Chief Counsel recruitment efforts, I enclose the following information:

Attachment A -- A list of all 175 ABA accredited schools to which we have sent recruiting literature.

Attachment B -- A list of schools by region which shows the visitation dates during 1986 & 1987, the offers made, the dates of the offers, the number of acceptances, and the reporting dates of those accepting the offers.

I trust that the enclosed information will be helpful to you and, if I can be of further assistance, please let me know.

Sincerely,

WILLIAM F. NELSON

Enclosures

ATTACHMENT A

Albany Law School (Union University)
American University (D.C.)
Antioch School of Law

Arizona State University

Baylor University
Boston College
Boston University
Brigham Young University
Brooklyn Law School

California Western School of Law
Campbell University (North Carolina)
Capital University
Case Western Reserve
Catholic University of America
Catholic University of Puerto Rico
Cleveland State University, The
College of William & Mary
Columbia University
Cornell
Creighton University

Delaware Law School of Widener College
Detroit College of Law
DePaul University
Dickinson School of Law
Drake University
Duke University
Duquesne University

Emory University

Florida State University
Fordham
Franklin Pierce College

George Mason University
Georgetown (D.C.)
George Washington University, The
Georgia State University (Atlanta)
Golden Gate University
Gonzaga University

Hamline University
Harvard University
Hofstra (N.Y.)
Howard University (D.C.)

Indiana University (Bloomington)
Indiana University (Indianapolis)
Inter-American University of Puerto Rico
Iowa (Iowa City)
ITT Chicago-Kent College of Law

John Marshall Law School, The

Lewis & Clark College
Louisiana State University (Baton Rouge)
Loyola University (Chicago)
Loyola University (Los Angeles)
Loyola University (New Orleans)

Marquette University
McGeorge School of Law
Memphis State University
Mercer University
Mississippi College of Law

New England School of Law
New York Law School
New York University
North Carolina Central University
Northeastern University (Massachusetts)
Northwestern (Chicago)
Northern Illinois University
Northern Kentucky University
Nova University (Florida)

Oral Roberts University
Ohio Northern University
Ohio State University, The (Columbus)
Oklahoma City University

Pace University (N.Y.)
Pepperdine University

Rutgers University The State U. of New Jersey (Camden)
Rutgers University The State U. of New Jersry (Newark)

St. John's University (N.Y.)
Saint Louis University
St. Mary's University (Texas)
Samford University
Seton Hall University
South Texas College of Law
Southern Illinois University (Carbondale)
Southern Methodist University
Southwestern University (Los Angeles)
Stanford University

Stetson University
Suffork University
Suny (Buffalo)
Syracuse University

Temple University
Texas Southern University
Texas Tech University
Thomas M. Cooley Law School
Touro College of Law (N.Y.)
Tulane

University of Akron, The
University of ALabama
University of Arizona
University of Arkansas (Fayetteville)
University of Arkansas (Little Rock)
University of Baltimore
University of Bridgeport
University of California, Berkeley (Boalt Hall)
University of California, Davis
University of California, Los Angeles
University of California, San Francisco (Hastings)
University of Chicago, The
University of Cincinnati
University of Colorado (Boulder)
University of Connecticut (Hartford)
University of Dayton
University of Denver
University of Detroit
University of Florida
University of Georgia (Athens)
University of Hawaii (Manoa)
University of Houston
University of Idaho
University of Illinois (Urbana)
University of Kansas
University of Kentucky
University of Louisville
University of Maine (Portland)
University of Maryland (Baltimore)
University of Miami (Florida)
University of Michigan, The (Ann Arbor)
University of Minnesota (Minneapolis)
University of Mississippi
University of Missouri (Columbia)
University of Missouri (Kansas City)
University of Montana
University of Nebraska (Lincoln)
University of New Mexico

University of North Carolina (Chapel Hill)
University of North Dakota
University of Notre Dame
University of Oklahoma
University of Oregon
University of Pennsylvania
University of Pittsburgh
University of Puerto Rico
University of Puget Sound
University of Richmond
University of San Diego
University of San Francisco
University of Santa Clara
University of South Carolina
University of South Dakota
University of Southern California
University of Tennessee
University of Texas (Austin)
University of Toledo
University of Tulsa, The
University of Virginia
University of Washington (Seattle)
University of Wisconsin (Madison)
University of Wyoming
Utah

Valparaiso University
Vanderbilt
Vermont Law School
Villanova University

Wake Forest University
Washburn University of Topeka
Washington (St. Louis)
Washington & Lee University
Wayne State University
West Virginia University
Western New England College
Whitter College (Los Angeles)
Willamette University
William Mitchell College of Law

Yale University
Yeshiva University (N.Y.)

ATTACHMENT B

1. CENTRAL REGION

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
Capital University	9/86			
Case Western Reserve	11/86, 2/87, 4/87	12/8/86 12/22/86	yes yes	8/87 - 9/87 8/87 - 9/87
Cleveland Marshall	10/86, 2/87			
Salmon P. Chase	9/86	12/12/86	yes	8/87 - 9/87
University of Cincinnati	9/86	12/5/86	yes	8/87 - 9/87
Cooley	9/86 9/86 9/86	12/19/86 12/11/86 12/12/86	yes yes yes	8/12/86 3/17/87 3/30/87
University of Dayton	9/86			
Detroit College	9/86			
University of Detroit	9/86			
Indiana University (Bloomington)	9/86			
Indiana University (Indianapolis)	9/86			
University of Kentucky	9/86			
University of Michigan	9/86	12/12/86	yes	4/27/87
Notre Dame	9/86			
Ohio Northern	9/86			
Ohio State	4/87	12/5/86	no	
Valparaiso	9/86			
Wayne State	9/86	11/7/85	yes	9/2/86
West Virginia	9/86			

2. MID-ATLANTIC REGION

LAW SCHOOL	DATE(S) of VISITS(S)	DATE(S) OF OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
American		12/2/85	yes	9/29/86
		4/28/87	yes	8/87 - 9/87
University of Baltimore		12/23/86	yes	8/87 - 9/87
Catholic University		12/19/85	yes	9/12/86
Delaware	1/86, 3/87			
Dequesne	10/86	12/18/86	yes	8/87 - 9/87
George Mason		12/3/86	yes	8/87 - 9/87
Georgetown		1/27/86	yes	9/2/86
		11/21/86	yes	8/87 - 9/87
		12/22/86	yes	8/87 - 9/87
		3/10/87	yes	8/87 - 9/87
George Washington		12/11/86	yes	8/87 - 9/87
Howard Unversity		12/23/86	no	
University of Pennsylvania	10/86	4/21/87	yes	8/87 - 9/87
University of Pittsburgh	10/86	2/3/86	yes	9/2/86
		3/4/86	yes	9/2/86
		11/21/86	yes	8/87 - 9/87
Rutgers	9/86, 10/86	4/23/87	yes	8/87 - 9/87
Seton Hall	10/86	12/23/86	yes	8/87 - 9/87
Temple	9/86	12/11/86	yes	8/87 - 9/87
Villanova	9/86	12/11/86	yes	8/87 - 9/87
William & Mary	9/86	1/27/87	yes	8/87 - 9/87

3. MIDWEST REGI

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
Chicago - Kent		11/14/86	no	
		1/5/87	no	
Creighton	9/86	1/5/87	yes	8/87 - 9/87
DePaul University	Fall of 86'	1/15/86	yes	3/16/86
		1/5/87	no	
		1/27/87	no	
		3/10/87	yes	8/87 - 9/87
John Marshall		1/5/87	yes	8/87 - 9/87
Loyola Law School	4/86, 10/86	1/29/87	yes	8/87 - 9/87
		3/10/87	yes	8/87 - 9/87
Marquette University	10/86	1/27/87	yes	8/87 - 9/87
		3/10/87	yes	8/87 - 9/87
University of Minnesota	9/86			
Northern Illinois University	9/86			
Northwestern University	8/86			
St. Louis University		1/5/87	yes	8/87 - 9/87
University of Wisconsin	10/86	3/27/87	yes	8/87 - 9/87

4. NORTH ATLANTIC REGION

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
Albany	9/86	3/16/87	yes	8/87-9/87
Boston College	9/86	12/23/87	yes	8/87-9/87
Boston University	10/86	12/12/86	yes	8/87-9/87
Bridgeport	9/86			
Brooklyn	Spring 86	12/22/86	no	
		6/5/87	yes	8/87-9/87
University of Buffalo		12/16/85	yes	8/87-9/87
		12/16/85	no	
		4/21/87	yes	8/87-9/87
Cardozo	Fall 86			
Columbia	Fall 86; 3/87			
Cornell	4/86			
Fordham	Fall 86; 3/87	12/16/85	no	
		11/21/86	no	
		3/27/87	yes	8/87-9/87
Franklin Pierce		12/19/86	yes	8/87-9/87
Harvard	9/86			
Hofstra	Spring 86	12/22/87	yes	8/87-9/87
New York Law	Fall 86; 3/87	12/16/85	no	
		12/16/85	no	
New York University	Fall 86, 2/87, 3/87	11/22/85	no	
		12/16/85	no	
		12/22/86	no	

4. NORTH ATLANTIC REGION (Cont'd)

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
New England School	9/86			
Northeastern	9/86			
Pace	3/86			
St. John's	Spring 86	12/22/86 12/22/87	yes yes	8/87-9/87 8/87-9/87
Suffolk	9/86			
Syracuse	4/86			
Western New England	9/86			

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5. SOUTHEAST REGION

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
Cumberland Law School	9/25/86	12/22/86	no	
Duke	3/3/87			
Emory University	9/18/86			
University of Georgia	9/21/86	12/19/86	yes	8/87-9/87
Georgia State		12/31/86	no	
		1/8/87	yes	8/87-9/87
Mercer		1/21/87	yes	8/87-9/87
University of Miami	9/15/86	1/8/87	yes	8/87-9/87
University of North Carolina		12/19/85	yes	9/2/86
University of South Carolina	9/16/86	2/8/86	yes	8/4/86
Tulane		11/25/85	no	

6. SOUTHWEST REGION

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
University of Arizona	10/86			
Arizona State		11/28/86	yes	8/87 - 9/87
		12/12/86	yes	8/87 - 9/87
Baylor	10/86			
Brigham Young University	10/86	11/6/86	no	
University of Colorado		12/11/85	no	
University of Denver	9/86	1/27/87	no	
		3/26/87	yes	8/87 - 9/87
University of Honolulu	10/86, 3/87			
University of New Mexico	3/86, 4/86, 10/86, 3/87	12/19/86	yes	8/87 - 9/87
		12/11/85	no	
Oklahoma University	10/86	12/19/86	no	8/87 - 9/87
Oklahoma City University	10/86	1/18/87	yes	8/87 - 9/87
		1/27-87	no	
St. Mary's University	10/86	4/21/87	yes	8/87 - 9/87
South Texas	10/86	3/4/87	yes	8/87 - 9/87
University of Texas		12/12/86	yes	8/87 - 9/87
		2/4/87	no	
Texas Southern	10/86			
Texas Tech.	10/86	12/3/86	no	
University of Tulsa	10/86	12/19/86	yes	8/87 - 9/87
		2/17/87	yes	8/87 - 9/87
		5/28/87	yes	8/87 - 9/87
University of Wyoming	9/25/86	12/19/86	yes	8/87 - 9/87

7. WESTERN REGION

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
University of California, Davis	4/86 & 9/86			
UCLA	9/86	3/20/87	yes	8/87-9/87
California Western School of Law	9/86			
Gonzaga University	4/86; 3/87; & 4/87	12/19/86 1/29/87 5/12/87	yes yes yes	9/26/86 8/87-9/87 8/87-9/87
Hastings		12/22/86	yes	9/26/86
University of Hawaii	10/86	4/28/87	yes	8/87-9/87
Lewis and Clark College	4/86	12/23/86 6/3/87	yes yes	9/26/86 8/87-9/87
Loyola University (LA)	9/86			
McGeorge School of Law	9/86			
University of Oregon	4/87	4/21/87	yes	8/87-9/87
Pepperdine University	9/86			
University of San Diego	10/86; 5/87			
University of San Francisco		5/1/86	yes	9/26/86
University of Santa Clara	9/86	11/12/85	yes	9/2/86
University of Southern Cal.	9/86; & 4/87	12/11/86	yes	9/26/86
Southwestern University	9/86			

7. WESTERN REGION (Cont'd)

LAW SCHOOL	DATE(S) of VISIT(S)	DATE(S) of OFFER(S)	ACCEPTANCE	REPORTING DATE(S)
University of Utah		11/24/86 12/19/86	no yes	9/26/86
University of Washington	11/86; 3/87	5/16/87	yes	8/87-9/87
Whittier	9/86	12/23/86	no	
Williamette University	4/87			

Chairman PICKLE. We are going to try to make an analysis, again, of what you have stated and what you have now accepted, it was not a misunderstanding, and it was just a matter of emphasis.

We will re-examine the black and white that we see before us and may have additional questions, but we appreciate both of your appearance.

Mr. SCHULZE. Mr. Chairman, if I may be allowed to make an observation, I would say that if everything goes as well as is projected and predicted, Larry Gibbs ends up as a hero. But if everything falls apart then he ends up in the frying pan, so I hope that things go well.

Mr. GIBBS. So do I, Mr. Schulze. [Laughter.]

Ms. STATHIS. So do we.

Chairman PICKLE. Well, on that peaceful note we will thank both of the groups for appearing. Thank you, Commissioner, for appearing.

The next panel will consist of our good friend former Commissioner Roscoe Egger, former Commissioner Jerome Kurtz, former Commissioner Sheldon Cohen. The Chair will ask you all to come here, but let me inquire of the three Commissioners, we have a vote on. I think it is a pro forma vote. I think the Chair will ask us to just take a recess for about 10 minutes and you all can just get comfortable and we will be back in approximately 10 minutes to resume and I think we can move forward rapidly then.

The committee will recess for 10 minutes.

[Brief recess.]

Chairman PICKLE. We will ask that the subcommittee please come to order again. I express my appreciation to our panelists for the slight delay, but we welcome you back here to the committee.

All of these gentlemen are our former Commissioners. I want to take special recognition of the fact that Roscoe Egger is back with us. I do not know, Commissioner, whether you have missed us, but we have missed you.

I also would observe that I do not guess anybody in America is more personally cognizant of what is going on in the overall advancement of the IRS services than you, who has given us such immediate good service. So we are grateful to you for this service and we appreciate the fact that you would appear with us this morning.

Mr. EGGER. Thank you, sir.

Chairman PICKLE. Before I recognize former Commissioner Cohen and former Commissioner Kurtz I wanted to personally welcome you here to the committee and may I also personally say to Mr. Kurtz that I appreciate the appearance you made last week on the "Nightline" program.

You came to the defense of the Commissioner, well and appropriately. I am glad that you were on that program. I was distressed at the first part of it, but I am glad you could make your observation.

Mr. Cohen, we are always glad to have you back. You are a regular attendant and we appreciate that.

Now, Commissioner Egger, if you will proceed with your statement first, we have your written statement. All of your statement will be included in the record and we welcome you to the committee.

STATEMENT OF ROSCOE L. EGGER, JR., ESQ. (PRICE WATERHOUSE, WASHINGTON, DC), FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. EGGER. Thank you, Mr. Chairman. I really appreciate the invitation and chance to be here. As you know full well, I am not a stranger to the committee. However, it is new for me to be up here in the role of a private citizen, so I am enjoying this immensely.

If I may, Mr. Chairman, I would like to just make a few comments along the lines of my prepared testimony and then let the prepared testimony be in the record.

Chairman PICKLE. It will be so ordered.

Mr. EGGER. I think that we need to take a look at the fact that now that the last of the tax returns that are going to be filed by April 15th are in place that both this subcommittee and the Internal Revenue Service can certainly look back on this filing season as even further proof positive that they have been and are on the right track.

I had the opportunity to be in the Cincinnati Service Center just about a month ago and the records that they are making this year in returns processing are simply outstanding.

Looking at the budget for 1988, the Administration's request represents certainly a major step forward with regard to overall tax administration. However, it is to some extent oriented rather heavily to enforcement.

Now, the initiatives here, particularly in the exam and collection, together are going to raise something over $15 billion by 1992. These are not new taxes. They are simply taxes that will be collected that perhaps otherwise would not have been collected.

However, there is a lot of skepticism, or some has been expressed here in these hearings about the forecasting of those figures. I just want to say this, that when it comes to staffing increases for the Internal Revenue, the existing computer models which they use and the empirical data makes it clear to me, at least, that this is real revenue that we are talking about.

For those who doubt this proposition I suggest they take a look at history. The first revenue initiative took place from 1983 to 1985. In support of that initiative I had informed the Administration and the Congress that for an outlay of $500 million the Service would collect just over $7 billion. Well, Mr. Chairman, I was wrong. We collected, in fact, $9.5 billion in that period.

As important as revenue is, however, it is also my sincere hope that these improvements on the compliance side are being undertaken for the right reasons. Let me just mention those.

First, the historical decline of the audit coverage has been troublesome to me and to, I am sure, some of the folks that preceded me as well as to Mr. Gibbs. That needs to be improved. An expanding account receivable balance is of deep concern. And certainly, the failure to use all of the information that the service gets in the information returns program.

Again, I have to say that part of the reason for the audit coverage and so on is not only to catch those who are not willingly paying their rightful share, but to see that the system works the way it should, to monitor the system, in effect.

I would consider it wrong for this kind of initiative to be undertaken solely for the purpose of meeting, lets say, a Gramm-Rudman target and then drop it by the wayside. I think that kind of a one-shot revenue approach would be terribly wrong.

As good as I think the budget is from the standpoint of enforcement, I have to say also that I think it goes exactly the wrong way in terms of taxpayer service. The taxpayer service decrease is, I think, most unfortunate because it calls for a cut of almost 200 staff years in that particular category. I think that these estimates that a level of service of 65 percent is simply inadequate—as I recall in my schooldays, 65 was about a D maybe, or a D-minus, and that does not sound like such a great deal.

Perhaps the saddest aspect of taxpayer service is that the very significant drop in service comes at the very time when both the IRS and the public are faced with the most sweeping tax law changes in my memory. Millions of taxpayers who are unnecessarily confused and intimidated, even, will not be able to get their questions answered. We simply cannot afford to alienate taxpayers by failing to give them the kind of service they need as a result of skewing the budget too heavily towards enforcement and not enough towards taxpayer service.

Taxpayer service is a part of this budget that goes directly to support voluntary compliance. When you consider, Mr. Chairman, that of the total revenues collected, about 95 percent are collected strictly on the basis of voluntary compliance; and that simply says to me that if we allow the voluntary compliance level to drop even slightly, the damage to the system will be something that may not be retrievable.

I would like to make one or two more comments here of a general nature. First, with regard to the salaries and expense appropriation, and the proposed absorption here of about 1,400 positions and $159 million. One of the lessons that I had thought we learned from the 1985 filing session was that you can stretch resources just so far.

In the period from 1981 to 1985 we stretched the so-called overhead expenditures in the Service Centers to the breaking point. I am concerned that potential problems of a similar nature could arise from further cuts in the salary and expense part of the budget.

The salary and expenses portion of the appropriation has been reduced from 1985 to 1986 and then from 1986 to 1987 and now from 1987 to 1988. Quality management is essential and the quality initiatives that have been undertaken and are being undertaken by the Service are, in my judgment, the salvation of the system. I think that for us to cut now in the management end of the Service is going again the wrong way.

Before I close, let me say one good thing about the fiscal year 1988 budget. First, from a management of resources standpoint probably the most important positive feature of the budget is the increase in the inter-appropriation transfer authority to 5 percent.

The existing split-up of this budget in four separate appropriations complicates the internal administration of the Internal Revenue Service. The functions of the various organizations within the

Service are interrelated and interdependent and the artificial separation of those items just simply is not productive.

So at a minimum the Congress should approve this 5 percent transfer authority. This would permit the Commissioner to make judgments on the basis of events as they transpire rather than having decisionmaking be set in concrete for 2 to 3 years ahead of time.

In closing let me say that the 1988 budget represents a very significant improvement on the compliance side and one which I hope will continue. I hope it reflects a new understanding of the ability of the Service to not only produce additional budget receipts but do a lot to buoy up the voluntary compliance through an effective enforcement program. But it is essential, that the taxpayer service not be neglected.

It has been, and is my judgment that this must be turned around.

So with that, Mr. Chairman, I would be happy to answer any questions you may have.

[The statement of Mr. Egger follows:]

Statement of Roscoe L. Egger
(Former Commissioner of the Internal Revenue Service)
Before the Committee on Oversight
House Ways and Means Committee
April 23, 1987

Good morning Mr. Chairman and members of the Comittee. My name is Roscoe L. Egger. I had the privilege of serving as the Commissioner of Internal Revenue from 1981-1986. Currently, I am a consultant for the accounting firm of Price Waterhouse. However, my testimony today is in my individual capacity.

Overview

I very much appreciate your invitation to testify at this hearing on the adequacy of the FY 88 IRS budget. This is my first opportunity to come before this committee in my role as a former Commissioner.

Of course, neither this subject nor this committee are new to me. Over the past years, I have come before you on numerous occasions to talk about budgets, operations, and many other matters. This committee's interest in sound tax administration is well documented and its contributions have been very substantial. In particular, Mr. Chairman, your willingness to go to the Chairman and members of the Appropiation Committees, and to help to make the case of the IRS has had a very important and positive effect on the ability of the Service to operate fairly and effectively.

It is also heartening to see these efforts supplemented by those of Mr. Dorgan who has first-hand experience with the trials of managing a tax administration system.

With April 15 again behind us, the IRS and this committee can look back at a very successful year. Once again, the IRS has processed more returns, issued more refunds, and collected more tax than ever before. This year has also seen very substantial progress in the reduction of problem inventories that have plagued the service centers for the last few years. It is especially pleasing to me to see the Service bringing to fruition many of the important and exciting initiatives that were begun during my tenure. Some of these are obvious like the electronic filing project and the automated examination system. Others are more subtle, yet equally important, such as the many quality initiatives throughout the organization, the establishment of more realistic production rates in the centers, and many other positive changes.

FY 88

Despite some deficiencies in key areas of the budget, the Administration's FY 88 request represents a very significant step forward for sound tax administration. Most striking of these are the various revenue initiatives. For example, the budget contains the second installment of the examination revenue initiative. The information returns program will be increased to assure more complete use of the data already collected. And, the collection function will receive a substantial increase to deal with the very troubling accounts receivable inventory.

These initiatives are expected to raise more than $15 billion by 1992. These are not new taxes, but amounts that would otherwise be owed, but largely never collected.

Now I know that in this age of blue smoke and mirrors, some are skeptical of revenue increases that come from increased compliance. And, when it comes to some tax law changes, I sometimes share this skepticism. However, in the case of staffing increases for the Internal Revenue Service, the existing computer models and actual empirical data make it clear that this is real revenue.

For those who doubt this proposition, I suggest they look at the history of the first revenue initiative that took place from 1983 to 1985 while I was Commissioner. In support of this initiative, I had informed the administration and the Congress that for an outlay of $500 million the Service would collect just over $7 billion. I was wrong, we collected $9 1/2 billion.

As important as revenue is, it is also my sincere hope that these improvements on the compliance side are being undertaken for the right reasons. By the right reasons, I mean such considerations as:

- o The need to remedy the historical decline in face-to-face examinations,
- o The need to deal with a rapidly expanding account receivable balance,
- o The desire to make full use of the information available in the IRP program,
- o The need to monitor the system to see where it breaks down or develops weaknesses,
- o The overall need to maintain a sufficient compliance "presence" in order to deter those who would take advantage of the system, and also to assure those who voluntarily comply that they are not being taken advantage of.

The wrong reason for the initiatives would be a one time revenue grab to meet Graham Rudman Hollings targets. To fund these initiatives purely for a one shot revenue gain would be the wrong reason because such a philosophy goes against the grain of the voluntary compliance ethic that makes this the most efficient and effective income tax system in the world.

Budget Deficiencies

In order for the tax administration system to function effectively, the IRS budget must reflect a balanced approach. Not only does the Service need to examine returns and collect money, it must also inform taxpayers of their responsibilities, answer their questions, resolve their problems, and efficiently post their payments and process their returns. It is in these areas that the FY 88 budget is most lacking.

The glaring example is, of course, taxpayer service. Here, the numbers tell the story. I direct the Committee's attention to the IRS' initial budget request to the Treasury. This was before Treasury and OMB reduced the request. Of all the major programs in the budget, the one that contained the largest proposed increase was taxpayer service. In light of increased demand, and in particular in response to the massive income tax overhaul in the 1986 tax act, the IRS felt that to do the job right, it needed to increase its FY 87 experience by approximately 1500 staff years. Unfortunately, the administration's budget calls for a cut of almost 200 staff years.

I believe that GAO estimates that the FY 88 taxpayer service funding level will result in a "level of service of 65%". Without getting into the technicalities of the definition of level of service, when I went to school, 65% was a "D".

Perhaps the saddest aspect of the taxpayer service problem is that this very significant drop in service comes at a time when both the IRS and the public are faced with the most sweeping tax law changes in memory. Millions of taxpayers who are unnecessarily confused and intimidated will not be able to get their questions answered. This result is very disturbing, and it strikes me as being completely antithetical to the very thing the Congress sought to do in Tax Reform -1986.

Our tax system is based on the very fragile cornerstone of voluntary compliance. While beefing up enforced compliance programs is a part of what needs to be done, we cannot afford to alienate taxpayers by skewing the budget totally toward enforced compliance. The compliance side of the budget will put all those new revenue agents and revenue officers out in the field. Their actions will cause taxpayers to have questions and account problems. Will the IRS be able to resolve them in a timely manner? If not, what will be the result?

It is important to remember that taxpayer service is the part of the IRS budget that goes directly to support voluntary compliance. And, after all, voluntary compliance accounts for about 95% of the revenue that the IRS collects.

Of course, the real problem facing the neglected programs like taxpayer service, returns processing and even tax fraud, is that they are not formally scored for revenue production. As a personal matter, I believe each of these programs more than pays for itself through increased voluntary compliance. Take taxpayer service for example. If a taxpayer is unsure of the treatment of an item and calls the IRS to see if, say, a deduction is permissible, what happens if the IRS does not answer the phone call? Human nature would suggest that the taxpayer would choose the most favorable treatment. Unfortunately, the FY 88 budget level in this area will simply force the failure to answer millions of telephone calls just like that one.

Beyond some of the program specific problems in the budget, I would like to make a few comments on two more general items. These comments relate to the salaries and expenses appropriation and to the proposed "absorption" loss of 1400 positions and $159 million dollars.

One of the lessons I hope we learned from the 1985 filing session was that you can stretch resources only so far. In the period from 81-85, we stretched so-called "overhead" expenditures in the service centers to the breaking point. I am concerned about the potential for similar problems in the salaries and expenses appropriation.

The salaries and expenses appropriation was reduced from 1985 to 1986, from 86 to 87, and now from 87 to 88. As part of the IRS' efforts to instill quality as a part of its internal culture, the highest quality managment and executive direction is essential. I am concerned that these cuts, though not large in dollar amounts, come at a crucial area.

Similarly, the budget contains a line item for the absorption of 1400 positions and $159 million dollars. I have real difficulty in understanding the logic of having made the decision to enhance the operations of the tax administration system and then starting off $159 million in the red. Perhaps, these cuts can be made, but they will have to be made up from some source. And, the favorite budgetese phrase of "to be absorbed from existing resources" is at best uninformative.

Before I close, let me say one more good thing about the FY 88 budget. From a management of resources standpoint, perhaps the most important positive feature of the budget is the increase in inter-appropriation transfer authority to 5%. The existing split of the IRS budget into four separate appropriations needlessly complicates the internal administration of the IRS. The functions of the various organizations within the IRS are so inter-related and inter-dependent the artifical separation of these items is not productive.

At a minimum, the Congress should approve the current request for a 5% transfer authority. This change would seem to address legitimate Congressional concerns on how approprations are spent, but at the same time would permit the Commissioner the flexibility needed to address problems as they arise.

In closing, let me say that the FY 88 budget represents a very significant improvement on the compliance side. I hope this reflects a new understanding of the ability of the IRS to produce in budget receipts a multiple of the amounts appropriated to it. However, the program for a more vigilant IRS must be supplemented by the taxpayer service and other support programs that are key to our system of voluntary compliance.

Thank you for your invitation, and I would be pleased to try to answer any questions that you might have.

Chairman PICKLE. Thank you very much. I appreciate your very poignant observations and recommendations on that.

Now we will ask for Mr. Jerome Kurtz, a former Commissioner, to make his statement.

STATEMENT OF JEROME KURTZ, ESQ. (PAUL, WEISS, RIFKIND, WHARTON & GARRISON) FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. KURTZ. Mr. Chairman, Mr. Frenzel, I am pleased to be here and to help the Committee in any way I can. I have a written statement which I assume will be made part of the record and I will summarize it.

I would like to make one or two observations about the GAO testimony. The GAO testimony should not be misunderstood, and I think it is susceptible to that. The IRS probably, does not have, state-of-the-art management systems in place. It is working toward that goal, but it is a very complicated process.

Nevertheless, decisions have to be made and the direction of those decisions is quite clear. It makes little difference whether the return on audit yield is 5 to 1, or 6.5 to 1, or 7.3 to 1. that is not of critical importance. What is important is that there is a large tax gap, that compliance is falling, that the Service is underfunded and that it is unable to do the job it should be doing. Not enough returns are examined. Accounts receivable backlogs are too big. Correspondence backlogs are too big. Taxpayer service is at a low level. The IRS needs more money in all of these categories.

So, whether the IRS has the most sophisticated management systems in place is largely irrelevant to the question of whether it needs more resources. How would GAO answer the question, if it were put to them of whether the current IRS staffing is just right or would it be better off to have more or less. That is the question that has to be answered.

It is not enough to say, "well, we do not know because there are not sophisticated management systems in place." Well, the IRS ought to try to improve its management systems. At the same time, we should not let that become more important than common sense. Common sense dictates that the IRS does not have resources to do the kind of job that it ought to do.

Secondly, I think focusing on direct yields, while that is a traditional approach, and direct yields are not unimportant, really misses the point. The IRS's own evidence on the tax gap indicates that only somewhere between 80 or 82 percent of taxes that ought to be paid are being paid voluntarily. A 1 percent improvement in voluntary compliance would increase revenues by about $5 billion, or significantly more than the entire IRS budget.

There is not any question that compliance will not improve without additional funding for the IRS. Therefore, one has to applaud all of the budget additions that are being proposed, but at the same time can regret the additions that are not being made.

I agree with everything that Roscoe Egger said. Neglecting taxpayer service is a terrible mistake for a number of reasons. Congress last year enacted a tax bill of unprecedented magnitude

which, in my view, significantly improves the tax system, increases its fairness, but at the same time makes radical changes.

People are going to be confused. The Service does not need extensive studies to know that. It is simply common sense. When people get their tax returns next year and begin to do them, they will find them different from the tax returns they filed the year before. There are new provisions which are radically different from prior provisions and which will be used very widely; employee business expense, miscellaneous deductions, changes in the medical expense, changes in almost every personal deduction.

If people are not asking questions about the changes then we have serious problems. I mean, people ought to realize that there are changes and for the new law to be implemented to carry out what Congress intended will require significant increases in taxpayer service. It is not enough to have 65 percent service. It is not, in my view, enough to have 85 percent service, particularly this year. We ought to have 100 percent service.

If someone wants a question answered they ought to be able to pick up the phone and get somebody to give them an accurate answer. That is money well spent. Someone who calls the IRS with a substantive question about whether an expenditure is deductible or not is a taxpayer who wants to do the right thing, who is trying to comply, and if we do not tell him, he is going to call the answer in his favor, and we are going to lose revenue.

The fact that we cannot measure exactly how much the loss is does not mean that there will not be a loss. So I think it is extremely important that taxpayer service, particularly in implementing the 1986 Act, be very well funded. People will require a lot of training. It is a new ball game and the IRS has got to have people in place to explain it.

One thing that you mentioned earlier in the hearings which I would like to pursue for a moment is that hearings on the budget always proceed, in my experience, from the notion of whether we should have a little bit more or a little bit less than last year. That is, instead of doing 1.3 percent audits, lets have a little more and then we can do 1.4 percent audits, or 1.5 percent audits.

What is missing is some judgment from the Internal Revenue Service as to what percentage of audit coverage is ideal, what is best, how high should it be so the Committee can know what is not being done that, in the judgment of the professionals, should be done in an ideal system. That does not mean everything will get done. There are not unlimited resources. We all recognize that. But we ought to know how far we are falling short of doing an adequate job.

I would like to mention a few other points. One is the problem that the IRS has faced over the years—I faced and I think every other Commissioner has—of seesaw funding. That is, tight budget, tight budget, tight budget, and then some kind of a disaster like accounts receivable get too high or a processing foul up and then money is added to make up for the gap, followed by more comstraints back and forth so that long range planning becomes virtually impossible.

There are mid-year changes, hiring groups and supplementals. There ought to be some process, two-year budgets or more, so that the Service can plan adequately.

Another point, which while a problem in other parts of the Government is particularly a problem, in the IRS, is that the pay scales in certain technical occupations are woefully inadequate and not competitive with the private sector, particularly accountants, lawyers, and computer specialists.

The tax law is getting more and more complex and the ability of the Service to hire a sufficient number of people with the needed technical skills is deminishing One reflection of the problem is in the accuracy of advice that is given by the IRS.

I would suggest that through the auspices of some organization—the GAO or the Committee or the Service—a study be made of what those gaps are in entry level positions and what it would take to make the Service a competitive employer. That does not mean the Service has to pay the same thing as private industry pays, but it cannot be so far off the mark that qualified people simply will not come in sufficient numbers.

One other point, which is peripherally related to the budget is that while the Service is frequently criticized on the Hill for the mistakes it makes, it is also well-loved in other circumstances, as witnessed by the number of miscellaneous non-tax chores that are given to the Service as a reward for its demonstrated efficiency; things like debt collection and tracing runaway fathers, et cetera.

All of those chores interfere with the ability of the Service to carry out its primary mission, both by diverting resources and by creating additional needless confrontations with the people with whom it deals.

The Service's role in collecting taxes is difficult enough without it becoming also the Nation's debt collector. It will just add to its image as public enemy number one.

That summarizes my statement, Mr. Chairman. I would be pleased to provide any answers that I can.

[The statement of Mr. Kurtz follows:]

STATEMENT OF JEROME KURTZ BEFORE
THE SUBCOMMITTEE ON OVERSIGHT
OF THE WAYS AND MEANS COMMITTEE
OF THE HOUSE OF REPRESENTATIVES
APRIL 23, 1987

Mr. Chairman, I am pleased to have been invited to participate in this hearing concerning the budget of the Internal Revenue Service for Fiscal Year 1988.

Needless to say, the efficient operation of the Internal Revenue Service is essential to the operation of our government. For too many years the Internal Revenue Service has lacked resources adequate to its task and the shortfall has grown. The Fiscal Year 1987 appropriation and the 1988 request reverse that trend and provide for significant increases in the staffing of the Internal Revenue Service, but in my view, do not address adequately some of the Service's most pressing problems. I offer the following comments for your consideration.

1. The 1987 and 1988 budgets provide for significant increases in the funding for the various enforcement functions of the Internal Revenue Service including examination of tax returns, document matching, collection, and their various supporting functions including appeals and litigation. What is lacking is any increase for taxpayer service. Even the modest increase in staffing taxpayer service from 1986 to 1987 is reversed in the proposed 1988 budget.

Failure to provide adequate funding for taxpayer service is, in my view, a serious mistake and extremely shortsighted. The decision can only be explained as the result of a myopic focus on direct revenue yields. While it is demonstrable that funds spent on collection or examination activities produce direct yields greatly in excess of the amount expended -- yields that may range from $7 to as much as $20 for each dollar spent -- and rendering efficient service to taxpayers does not produce such a direct, measurable return, it can hardly be doubted that total revenue collections will increase if the Internal Revenue Service is viewed by taxpayers as efficient, helpful and available. A taxpayer who telephones the Internal Revenue Service in the course of preparing his tax return to ask whether a particular expenditure is properly deductible is a taxpayer who is trying to comply with the law and who is trying to do the right thing. If, after numerous attempts, his call goes unanswered, he is likely to decide the question in his favor. That we will never know the revenue costs of the failure to answer such calls does not support the conclusion that funds spent for taxpayer service produce no additional revenue.

Adequate taxpayer service is important for another reason unrelated to direct revenue impact. I believe the government which imposes a tax has an inherent obligation to help its citizens in performing the task of calculating and paying that tax. The amount of revenue collected by the Internal Revenue Service as a result of direct enforcement, while substantial in the aggregate, is only a small portion of total tax collections. We look to taxpayers to meet their tax obligations without direct enforcement and adequate taxpayer service is a necessary ingredient of that goal.

2. I believe it would be helpful in connection with oversight hearings such as these, or in hearings before the appropriation committees, for the Internal Revenue Service to present its best judgment on what the ultimate goals of the Internal Revenue Service should be in its various functions -- how many tax returns should be examined under an ideal tax system?; what kind of service ought to be rendered?; how long should it take to have a telephone call answered?; and what accuracy rate is acceptable? These would not be goals to be achieved within a year and they might not be goals that could ever be achieved, but I believe it of

critical importance to know how far short of a fully efficient tax administration system we are. We should know what it is we are not doing that we could and should be doing.

3. Funding of the Internal Revenue Service over the years has been a seesaw affair -- tight funding for a few years followed by sudden attempts to make up for past deficiencies, which are in turn followed by further cutbacks. Efficient planning thus has been impossible, hiring has been sporadic, and morale has been low. Long-range planning in budget cycles is essential so that the Service can anticipate the funds that will be available not just next month but next year.

4. The pay scale of the Internal Revenue Service particularly in certain professional fields is simply not comparable to private industry -- and not comparable by a wide margin -- with the result that even given the funds to hire more people, there are insufficient numbers of people with the training and abilities required who are willing to work for the Service. This is a problem both at the entry level, and just as importantly, at the senior executive level. The problem is particularly acute as to accountants, lawyers, and computer specialists. I would recommend that the Internal Revenue Service, under the auspices of this Committee or the General Accounting Office, undertake a study of comparable pay in these fields with a view to making the IRS pay scales more competitive.

5. Although the Internal Revenue Service is often criticized for its inefficiency, it nevertheless on many occasions is viewed by Congress as being so efficient at what it does that it warrants being given additional chores wholly unrelated to tax collection.

There seems little doubt that within the Federal government the IRS is considered a well-run organization but one would hope that the reward for its efficiency would not be additional tasks unrelated to tax administration. Such tasks dilute the Service's ability to fulfill its primary obligation both by diverting resources and by creating unnecessary controversy and ill will. The Internal Revenue Service should not be the nation's debt collector and I would strongly urge this Committee to resist the urge to add additional chores to the already overburdened Internal Revenue Service and to consider removing some of the burdens already given it.

I appreciate the opportunity to appear before you and would be pleased to answer any questions you may have.

Chairman PICKLE. We thank you for a very good statement, Commissioner Kurtz, and we appreciate your appearance here today.

Now, Commissioner Cohen, I do not have a statement in front of me, but we will be glad to have your statement.

STATEMENT OF SHELDON S. COHEN, ESQ. (MORGAN, LEWIS & BOCKIUS, WASHINGTON, DC), FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. COHEN. Mr. Pickle, I apologize. As I mentioned to your staff, due to some other emergencies I was not able to submit a formal statement.

Chairman PICKLE. We will be glad then to receive your summary.

Mr. COHEN. Thank you, Mr. Chairman, Mr. Frenzel.

I endorse what Mr. Kurtz and Mr. Egger said wholeheartedly. I applaud this committee's continuing concern about the adequacy of the IRS budget and its operating problems. Your oversight is a constructive thing. It is something that has only existed in recent years as this committee has become more and more interested and I think it has helped the Service in dealing with its problems and pointed up those problems.

You have both a friendly critic and a constructive critic at the same time, and I think you have managed to do that. I have many concerns, as my fellow former Commissioners do, about this budget. As Mr. Kurtz said, I have those concerns, in terms of the health of the Service in dealing with this very complex new statute.

Everybody talks about simplification, but those of you who worked on the new law and those of us who are technicians dealing with it know that there is a great deal of complexity in getting from here to there. And indeed, many of the provisions of the law dealing with complex businesses are much more difficult and more complex to deal with than the old ones.

So we will have a great many problems. Every change, as Mr. Kurtz said, is a complication, just by the fact that there is a change. Because of the compromises that were made in getting the legislation through true simplification did not occur. There are always a few exceptions you added and the transition rules are impossible to understand for the normal human being, as well as for us.

You have a whole new set of terms, a zillion new terms that are going to have to be defined by the Revenue Service, the whole passive loss concept, increased sensitivity to the alternative minimum tax; a variety of things, and I can go on and on and on in that area.

The point is that we need a great deal of help, and this is in two areas; one that these two gentlemen have mentioned to the taxpayer service. I am also concerned with the Service and the Treasury's ability to get out timely rules and regulations.

It seems to me that there is a lack of sensitivity at some levels of the Treasury Department in dealing with the regulation and the rulings process. They have built up an encrusted system of reviews and reviews and reviews. As we move up that system the funnel becomes very narrow with only a few people involved. These people work on both legislation and regulations are diverted to legislation which takes priority. I believe that we will find that if we do not

change the system and truncate those reviews we will find ourselves in a state of strangulation about 6 months or a year out, and give the Commissioner's office a little more authority to put out rules and regulations--at least in proposed form, without detailed substantive review at Treasury.

That is a prediction on my part not based on concrete study within the Treasury, because I am not within the Treasury. It is based on my experience in dealing with regulations as a technician—I was a technician who drafted regulations when I was young—and as Chief Counsel of the Revenue Service and as Commissioner. As an observer of the Revenue System, I think that there is going to have to be serious thought both here on the Hill and at Treasury and in the IRS as to how that process can be streamlined and those rules moved along in a more rapid, probably a little less formal fashion.

In terms of the budget concern, this Committee has expressed the right kinds of concerns. I am disturbed by the attitude particularly of OMB. I say this in a nonpartisan sense because it is OMB under the last couple of administrations which have viewed the Revenue Service as fungible with every other spending agency. They have not viewed the time of deficit as a time when one should look to enhance as rapidly as possible the revenue collection, and hopefully, as Mr. Egger says, the voluntary compliance system. This is short sighted.

I think that perhaps this Committee or some appropriate Committee ought to look at that attitude, because as you asked the Commissioner this morning, did you recommend higher levels here. The answer was yes. It was OMB which cut back the budget.

Of course, the Commissioner has to answer, yes, it is an adequate budget—because that is what he is instructed to do. I have had to do that too, on occasion. The real question—and you asked him the real question—is did you need the resources when you asked for them? Are the cuts justified? Did you have a rational discussion or were you just imposed upon? Did they tell you to knock off 5 percent or 7 percent or whatever the number was?

I think that is an important concern. I agree with Mr. Kurtz that someone somewhere ought to set what an ideal audit level was. I was embarrassed. Maybe I blushed a little when he said that, because we had an audit level of 4.5 percent and our ideal was 5 percent. We are so far off of that now that it would be laughable to try to set a goal that high.

Of course, part of that is definitional. Whether an arithmetic correction is considered an audit or not would affect those ratios. I would encourage the staff of your Committee and the staff of the Commissioner to work toward a goal. This will give you some personnel targets over a period of time and then you could work towards that in a steady progression that Mr. Kurtz and Mr. Egger said, instead of the seesaw type budget where you go up one year and down the next.

In terms of the IRS personnel, I have a personal experience. I have a son who graduated this year and I encouraged my son to go to the IRS, where I had started my career. My son has a bachelor's from the Wharton School and he has a master's in accounting. The IRS was willing to pay him a little more than half of what he ulti-

mately got in private industry. Now, he said to me that if they were even close he would have taken the Government job. He then said "I cannot pay my rent in Washington, DC, on what they are offering."

Now, that is non-competitive. Also the fact that they cannot make their commitments early enough to catch the good young people's eyes. The good young people may be interested. They might like to have experience in the Service. But they need two things. They need a commitment early enough so that it is competitive in the sense that it is there at the same time the other offers are coming in, and it has got to be competitive in terms of price.

Now, the attraction of the job will be there so that many young people, as I did when I was young, would take the job even at a differential. But not at a 50 percent differential. Most people will not do that. So it is important that this Committee and the Congress look into this area of security.

I have many other comments but I think they are in line with what these other gentlemen have said so I will stop right now.

Chairman PICKLE. Well, I thank you for your statement, and I thank all of you.

Let me start off in a more specific nature. I take it that all three of you agree that the cut in taxpayer service is damaging and that it must be increased in this budget for 1988. Is there disagreement on that?

Mr. COHEN. No. I think I would agree with these gentlemen. The problem is if it is cut too hard you will not know it until it is too late, and then you cannot repair it, as Mr. Egger said. A fall-off of 1 or 2 percent in people's voluntary compliance does not sound like a lot but it is billions of dollars and it is permanent. Once you have a fall-off of people's attitudes towards the Service that is hard to repair. It will cost you much more to bring it back that it would to have slightly increased assistance to maintain it.

Chairman PICKLE. Well, I am not asking if you would cut compliance or enforcement but rather if you would increase taxpayer services. Mr. Egger?

Mr. EGGER. Let me say this about it, that if you do not put the proper level of taxpayer service into that budget to begin with and later on you realize that gee, this is not going to work, this is not enough and so on, and you try to do it at the 11 hour, you run into all kinds of problems of training and preparing people for the jobs that they are supposed to do.

I can tell you from experience that when the Administration cuts a tremendous amount of taxpayer service out of one of my budgets and this Congress, to its great credit, restored that, it came at such a late date that we had difficulty. We had reassigned a lot of the trained people, and trying to put it back together at the last hour, even including trying to get the telephone company to get lines in became almost an impossibility.

And so what I am saying to you, Mr. Chairman, is that if you do not get this show on the road early enough in the game then the quality of the service suffers necessarily.

Chairman PICKLE. Do you all agree or do you disagree generally with the observation that the GAO had made. They are rather crit-

ical, if not negative, observations and the IRS indicated that they did not really like to read it, but they were quite sure they could interpret the intent of the statements or some sort of innocuous reply.

Do you agree with what the GAO is making by way of observations?

Mr. EGGER. No, I certainly do not and I have been long critical of the GAO for simply stating the obvious, which is that we are concerned about this or that without ever saying what ought to be done about it. They come up here as experts in this or that aspect of tax administration but only expressing the negative and never saying, this is what should be done. And that is my criticism of GAO.

Chairman PICKLE. Do you all agree with that?

Mr. KURTZ. Yes.

Mr. COHEN. Well, I think that Commissioner Gibbs read Ms. Stathis' comments properly. That is if you know the GAO style he read them properly.

I would disagree violently with one thing that she did say. That was her comment that the ability to reallocate by the Commissioner would give the Congress less control over the budget. That is nonsense. The Hoover Commission in the middle 1950's recommended that all Government agencies be given a performance budget. I would not say that Mr. Hoover was a great spendthrift, he was anything but.

Under this concept, the management of the agency is charged with a function, given a budget, and to go to do the job. And then if you do not like the way they did it, you get a new manager. Indeed, in the years that I was Commissioner I had a performance type budget and I transferred money as I would.

Of course I reported to the Congress, because if I did not report to the Congress I would not receive any budget next year. But I did not have to worry about, as they do now, these four pockets of interrelated money. This requires you to go through all kinds of paperwork for no purpose. Of course the Service will tell you that they use so much money for collection or so much money for auditors or whatever they used if for.

Chairman PICKLE. Are you saying that you would recommend the increase from 1 percent up to 5 percent?

Mr. COHEN. Of course go from 1 to 5 percent. I say this particularly because you do not know—none of us know—what is going to happen three weeks from today, much less a year and a half from today. You should give the Commissioner the moving room to be able to say that a function is now much more important than anybody dreamed of three years ago when we started this budget down the road and we must make a change.

Mr. EGGER. There is another aspect to that.

Chairman PICKLE. Are you saying that we ought to have no limitation on the interaccount transfers?

Mr. EGGER. Well, I want to footnote what Sheldon Cohen said. One of the problems with a subdivided budget into the four accounts is that then you get the Treasury, the OMB and everybody else making management decisions which are really the responsibility of the Commissioner, and lets take taxpayer service. He

cannot sit there and decide for himself whether 75 percent of 80 percent of whatever other level of service is fair.

Chairman PICKLE. I know that, Commissioner, but OMB is real. It is not something theoretical out there.

Mr. EGGER. I am well aware.

Chairman PICKLE. It is a big, tough giant out there and we just cannot say we ought not to let OMB make management decisions because they are not a budgetary matter. They are the Office of Management and Budget and we have to deal with them. So the question is how can we deal with them in the best manner.

Mr. EGGER. For that reason the transfer authority makes sense, is what I am saying. Certainly 5 percent.

Chairman PICKLE. Well, I do not think we would disagree with that, although that is a serious question. How far we would grant the authority is something that we would have to analyze. It may sound well for Mr. Cohen to say that he just had a budget and all he had to do was to report that budget to the Congress.

Well, life is not that simple any more. We have to kind of concern ourselves with what is being spent, and if some department needs more, then the Internal Revenue Service ought to recommend it. They ought to recommend what they really need, and they have not done that, and neither did you when you were probably Commissioners.

Mr. COHEN. No sir.

Chairman PICKLE. So you in a sense are kind of reformed sinners as Commissioners. You come in here now and you say you ought to do this—one, two, three, four, five, and every one of your points are well taken, but you did not recommend them in the fullest sense. You understand that, too, because we are not purists in the legislative field.

Mr. COHEN. Well, part of that problem is you start that budget process maybe anywhere from two to three years before the budget becomes operative.

Chairman PICKLE. Yes. All right.

Mr. KURTZ. Sheldon neglected to mention that when he was Commissioner there was no Oversight Committee. [Laughter.]

Chairman PICKLE. That is correct. And we are Oversight and we are not the Appropriations Committee. It might be well if we would have some of these hearings some time with a joint hearing between Appropriations and the Ways and Means Committee.

Mr. KURTZ. I think that would be a very good idea.

Chairman PICKLE. Yes.

Mr. KURTZ. I would like to make one observation about a GAO comment—a comment the GAO has made every year. It always criticizes the IRS budget request on the grounds that the Service did not have management information and a plan adequate to support the requested allocation of resources among the various functions. That is, there was no machine that would tell you how much of resources ought to go into collection as compared to examination as compared to taxpayer service.

I do not know what conclusion one draws from that criticism but the fact of the matter is that that is an impossible question to answer. There is no way to answer that question and there is no

way to set about to find a way to answer that question, because we do not know why people pay tax or do not pay tax.

I do not think we will ever know with the kind of precision that says voluntary compliance will improve if you spend $500 million more in collection and $300 million less in examination. Yet that is what one would have to know to answer to allocation questions, because the voluntary compliance level is the important issue, not the direct yields.

Chairman PICKLE. Well, I think that we would agree with you that taxpayer services should be increased, if for no other reason, than the new tax bill where the changeover is going to be enormous and we ought to be increasing help instead of cutting back on it. I have a feeling and hope that the appropriation will take that into consideration.

But we are having a problem knowing what level. If we increased taxpayer services as much as you would want to get an 85 percent level of telephone service, Mr. Egger, it would cost about $48 million. It would require putting on 1,025 new positions. That is just a general estimate.

Now, that is a big jump, and if we give Internal Revenue Service what they really asked Treasury to give them, that would require an increase of about $99 million, or at least 1,698 positions.

Now, can we get that? You say that is what we need. You can take your professorial position now as a retired Commissioner, and say that we ought to get what we need. But we have to ask ourself, I think really, what is the appropriate level of taxpayer services. How much, and I have asked you that, should taxpayer services be increased over the 1988 level. Are you prepared to say how much?

Mr. EGGER. Well, all I can say about that, Mr. Chairman—and this has to go on my recollection—that when I was there not too long ago the level of telephone at about 80 percent or thereabouts was felt to be reasonably adequate; 65 percent, I am satisfied, is just too low.

Whether 85 percent, yes that might be the ideal, but if you cannot get that much, then certainly in the 80 percent range should be pretty optimum. Now, I want to say also that $48 million in the scheme of things, considering the total budget and considering the total amount of revenue collected and things coming out of these initiatives, does not sound like an awful lot of money to me.

Chairman PICKLE. Well, let me give you an example. As I recall it, the 1988 budget would allocate $260 million and 5,700 positions for taxpayer services. Now, you say it ought to be increased, it is totally inadequate. How much would you increase it?

Mr. EGGER. I cannot tell you what numbers it would take to get that.

Chairman PICKLE. Can any of you? Do you want to give me an estimate or do you just want to take a general position?

Mr. KURTZ. I would think that certainly 85 percent is not too much service in the year in which you are first implementing a major new Tax Act.

Chairman PICKLE. So you would then say bring it up to 85 percent, and I assume that is what Mr. Egger was saying too.

Mr. KURTZ. Well, when I was there my recollection is, as Roscoe's is, that telephone service was in the low 80 percent levels, I

think, maybe 82 percent or something like that, and I must say, I thought that was grossly inadequate.

Mr. COHEN. If I called up a department store and only got them eight out of ten times I think that would be pretty sad.

Mr. KURTZ. Not only that, when they say 80 percent level, it is not that good. That does not mean that you will get your call answered, that eight out of ten people will get their call answered the first time they call. It does not mean that at all. It means that eventually 80 percent will get through with persistence. So it is not very good, is my point.

Chairman PICKLE. All right. But as I sit here—and I do not think we are arguing this at all—I am in general agreement with you that we ought to have more for taxpayer services. If we raise it to the level of 80 to 85 percent that you have made reference to, that means we would probably be recommending to the Appropriations Committee that they would add about 4,500 new positions.

Do you think that is real? Do you think that is going to happen? Well, you do not know that and I do not know it either.

Mr. EGGER. I do not know it either, but I would have to say this, that sooner or later this will come back to haunt if that level is not up there where it belongs.

Chairman PICKLE. Well, I think, Mr. Egger, you had said—or maybe it was Commissioner Gibbs, but one or the other, and you both probably would say it—that in effect if we want a first class top-notch Internal Revenue Service we have got to staff it with the positions it needs or it is not going to be a first class agency and it is going to be cussed and discussed.

It is going to be cussed anyway, because no tax collector is ever going to be popular, but if we are going to make it perform as we hope it will, I think we have got to up the number of positions. Yet we are in the real world now, what can you afford? You were faced with the same problems as we are today.

I think we can do better than we have done. I think that in certain areas we have improved. I think the attitude towards the Service has improved some within the last year or two, due to a lot of circumstances that have happened. Not mismanagement by any means, but the difficulty with problems in the computer field.

I think your recommendations are good. I hear you. I appreciate your testimony and I certainly thank you for being with us today.

Mr. Frenzel, do you have any questions?

Mr. FRENZEL. No, but I will make some comments.

It seems to me that the problem, at least from our standpoint, is that we exercise some oversight every now and again, but we do not consider any of the long term plans that you are calling for. In the last couple of years the moneys that have been added to the IRS have come as a matter of budget decisions that had nothing to do with how you function.

We get to the end of our budget, and then we decide we need $2 billion more in revenues. So we go to somebody—heaven knows who, a nameless, faceless gnome perhaps—and say, how many agents do we have to hire to generate $2 billion more. The faceless gnome gives us a number and then we put it in our budget and expect that money to come home to us.

Roscoe, you say that it did. Now, I assume when you get that money you rush out to all the agricultural schools and hire a bunch of sociology majors. Then they rush out into the field and do complicated audits and bring home bucketfuls of money.

That does not happen. You have to train the new people. You do not get any immediate return from them. How can you justify the assumption that you will bring in billions of dollars with these untrained personnel that we put into the IRS budget. The budget resolution is our letter to Santa Claus every year, and the IRS portion is the fuzziest part.

Mr. EGGER. But Mr. Frenzel, you are oversimplifying it and I think——

Mr. FRENZEL. I always do.

Mr. EGGER [continuing]. You are not really giving enough credit to the work that the Service has done over the last several years in their staffing models. Those models have now been reviewed by outside experts. They have been reviewed by the OMB.

Mr. FRENZEL. Not the GAO, have they?

Mr. EGGER. I do not know if the GAO has got anybody to look at them, but the Congressional Budget Office experts have looked at it. The Office of Tax Analysis in Treasury has looked at it, and everybody believes that those are very sophisticated estimates. They are not based on just some willy-nilly kind of ratio. They are based on taking into account every cost and all of the factors that enter into what it takes to bring a person on board, to fully train them, and then pursue it on up through the time when they are fully effective.

Mr. FRENZEL. Sure. But if that is the way we decide to fund you, how is any of that money going to slip into services? It is not, is it?

Mr. EGGER. The only way it can is for the Commissioner to exercise his transfer authority, if he has it, to not hire revenue agents and to hire people for this taxpayer service program.

Mr. FRENZEL. So it is no great surprise that all of you find the prospective budget deficient in taxpayer service, is it?

Mr. EGGER. Not to me.

Mr. FRENZEL. Does anybody have any other comment?

Chairman PICKLE. What was the answer to your question about how do we get this money back into our hands?

Mr. FRENZEL. Ex-Commissioner Egger holds——

Chairman PICKLE. Former Commissioner Egger.

Mr. FRENZEL. Well then, Citizen Egger says that they have models and that their training program is in high gear all the time. So that when they put somebody in at the bottom they are moving somebody out at the top who collects wheelbarrows full of money as a result of somebody coming in at the bottom. At least that is the way I understood him to have stated it. He says that the figures bear him out in that. It defies logic from my standpoint, but——

Mr. COHEN. Well, you have to feed in the lawyers and the appeals officers and the internal bookkeepers and the pencil buyers. All of that has to be fed in, of course, to match because you cannot just hire revenue agents and collection people. The Service will not work that way.

Mr. FRENZEL. But it seems to me that what we are lacking in both of the branches of Government is some kind of comprehensive long term plan for the development of a Service that will do what Congress wants it to do—that is, to pat all of our constituents on the head and file their forms for them and tell them they are wonderful people—and then to do what the Government needs to have done which is to collect all the money that is out there.

Mr. COHEN. The Service can give you a 5-year plan. They have it and you can review it.

Mr. FRENZEL. Sure, but we do not care.

Mr. COHEN. But you do not look at that.

Mr. FRENZEL. To us it is a budget matter and the only extra money we will give you is if it looks like it is going to increase the revenue side for us.

Mr. FRENZEL. Okay. Mr. Chairman, I yield the balance of my time.

Chairman PICKLE. Well, I thank you, Mr. Frenzel.

I thank the Commissioners. We appreciate the fact that you are being very positive about it, and more than realistic, but we need to be reminded of what we should do and I hope we can pass this information over as strong as possible to the Appropriations Committee and to the Administration. As you have a chance to see any of the leaders I hope you will join in making the request that we do better by the IRS as best we can and expect top performance out of them then.

Thank you very much.

Mr. EGGER. Mr. Chairman, could I take just a moment to thank you for what you have done and are doing to help the Service improve its budget situation. I know first hand what you have accomplished and I see history repeating itself and I am very grateful to you personally as well as a citizen.

Chairman PICKLE. Well I thank you and I am glad to have it on the record, Commissioner. Thank you all very much.

Now we are privileged to have a panel representing the Bar Association, American Institution of CPA's, the New York State Society of Certified Public Accountants, and the National Treasury Employees Union.

Will John B. Jones, Donald Skadden, Arthur Hoffman, and Robert Tobias please come forward. Our first witness from this panel will be John Jones, who is the chairman of the Section on Taxation, American Bar Association.

The second witness will be Donald Skadden, vice president-taxation for the American Institute of the Certified Public Accountants. Then representing the New York State Society of CPA's is Arthur Hoffman, chairman of that division, accompanied by Walter Primoff, director of tax policy. Then we will have Robert Tobias, president of the National Treasury Employees Union.

Mr. Jones, if you will proceed first. I assume you all have written statements and we have it. I will say to you and to the other members that we will include your entire statement in the record for the hearing. So, if you want to summarize or proceed, I hope none of you will take more than 5 minutes time in view of the time and hour.

Mr. Jones.

STATEMENT OF JOHN B. JONES, JR., ESQ., CHAIR, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

Mr. JONES. Thank you very much, Mr. Chairman. My presentation today is on behalf of the American Bar Association, not solely the Section of Taxation.

As we view it the present situation is not really a crisis, it is more of an opportunity. Since what was a near disaster or maybe an actual disaster two years ago, Congress, this Committee, the Administration and the IRS have in our opinion responded well.

There is much more to do and the Tax Reform Act of 1986 has changed the substantive, rules. If we make the right moves now in administration we really can have a more effective and more humane tax system in the 1990's. We believe that the revenue initiatives proposed by the Revenue Service and under consideration are appropriate. In fact, we believe the entire IRS budget could be called a revenue initiative.

Specifically, we think there are three areas that need the Subcommittee's attention. There are a large number of new positions envisioned for the Revenue Service. We would hesitate to increase that number too much simply because of the ability of the Internal Revenue Service to absorb them. We do, however, think the Commissioner's request to have transfer authority between the four accounts from the present 1 percent level to the 5 percent level is very important. His position is well taken. He certainly needs flexibility. No one can judge better than he what is needed to meet the problems as they come along.

We agree with the comments that have been made here continuously by a number of witnesses that taxpayer service is the most important thing to look at. In our view there is a job classification problem here. Others have talked about the difficulty of getting computer specialists and accounting experts. We suspect that the problem may be at more routine levels as well—the revenue agents and the people who answer those telephones. These are very skilled jobs.

We are not able to supply answer here but we think there could be a profitable study of whether the Revenue Service is being held back in carrying out its mission because of a failure of the system to recognize the level of talents which are required.

There are two things in the budget process which cause us concern. It seems to us that Congress itself may be part of the problems that exist and need to be dealt with in the Internal Revenue Service. First is the problem of operating on an emergency basis on continuing resolutions and the like. We do not think that you can meet the sophisticated kind of problems which the Internal Revenue Service has to do if you are going to be subject to continuing resolutions, emergency situations. Our suggestion is—and we say this with some temerity because we are not experts in the Congressional process—that we should have a two-year budget cycle so that the Revenue Service could know with assurance how much money it is going to have two years ahead. That would be a great assistance.

We also have noted over the years—whether anything can be done about it is beyond our ken—that when the Treasury Depart-

ment appropriation comes up it is at the same time as the Post Office. The Post Office is a great big bear and it is very hard to get the proper attention for IRS and Treasury. When things go wrong with the Post Office budget it may impact the Treasury budget. It would work better if the Treasury Department were separated out and dealt with in its own right.

We were asked to comment on the Tax Court docket. We think that it is a big problem but we believe that it is under control. We hope that the 1986 Act will eventually cut off the input side and it seems to us that the Tax Court and the Chief Counsel's Office are responding responsibly.

There is a suggestion by one of my colleagues on this panel that the Internal Revenue Service in its anxiety to solve the problem may be letting people off cheap. I can only say that that has not been my experience nor what I hear from our members. The consistency with which the IRS has set settlement lines and applied them across the board has been sinking home to the lawyers handling those cases and made them more realistic in what they can expect.

The recent announcements on tax settlements are clearly calculated to expedite the procedure but not to lessen the amounts which the taxpayers are going to pay. This ends my oral comments.

[The statement of Mr. Jones follows:]

STATEMENT OF JOHN B. JONES, JR.

ON BEHALF OF THE AMERICAN BAR ASSOCIATION

Mr. Chairman and Members of the Subcommittee:

Introduction

I am John B. Jones, Jr., Washington, D.C., Chair of the Section of Taxation of the American Bar Association. I appear here today at the request of Eugene C. Thomas, President of the American Bar Association with respect to the Administration's proposed fiscal year 1988 appropriations to the Internal Revenue Service. The 30,000 members of the Section of Taxation of the American Bar Association have long been concerned with the efficient and effective operation of the IRS, and we are pleased to present this testimony on behalf of the 300,000 members of the American Bar Association.

This testimony does not attempt to address specific line items of the IRS budget. We are, instead, addressing what we perceive to be major resource and structural problems with the IRS budget and the outside constraints on its operations, and are suggesting approaches to deal with these issues.

Summary

In its fiscal year 1988 budget, the IRS is requesting a revenue initiative -- the addition of 8,732 permanent personnel. The Service estimates that these added staff years will produce a revenue gain of $14 billion through fiscal year 1992. We support the concept of revenue initiatives. Indeed, we believe that the entire IRS budget should be viewed as a "revenue initiative."

However, we recommend that revenue initiatives be balanced. The additional resources should be distributed fairly among all IRS programs, including appeals, delinquent returns and collection of accounts receivable, as well as examination. More flexibility needs to be provided to the Service to move resources around, as circumstances dictate.

We endorse the expansion of the Service's document matching with emphasis on followup of returns with unreported income. Expediting resolution of tax shelter cases backlogged in administrative appeals is also an important initiative. Expansion of the collection of back taxes continues to be important. Continuing to improve computer systems is essential to keeping up with the filing of some 186 million primary returns each year.

Increased examination activity makes increased appeals activity a few years later a certainty. Unless IRS revenue initiatives are balanced and flexible, we run the risk of trading one form of inadequate IRS capacity for another form of inadequate capacity.

Substantial Progress From 1986

The Service has made substantial progress in carrying out its objective of better administering the income tax laws with the additional funding provided by Congress over the last two budget years. The recent study on Dr.. C. Eugene Steuerle, Deputy Assistant Secretary, (Tax Analysis), Department of the Treasury, confirms that there is an effective multiplier such that the expenditure of these funds will actually raise a substantially larger amount for the fisc. However, much still needs to be done to bring IRS operations fully up-to-date over the next few years. Most importantly, the Service has an historic opportunity to implement tax reform and restore much of the lost credibility the tax system has suffered through years of tax shelters and the nagging suspicion that many people do not pay their fair share.

Tax Reform Act of 1986

We are concerned that, although the budget increase appears reasonable in light of past budgets, in fact it may be too modest in terms of implementing and effectively administering the Tax Reform Act of 1986. If tax reform is to be functionally successful, it must be implemented properly and promptly.

We fully appreciate that the Service may have difficulty in recruiting and training more personnel than are included in its 1988 budget request. There are three primary areas that need the Subcommittee's attention.

First, we strongly support the Commissioner's request to increase his transfer authority between the four accounts of Taxpayer Services, Examination Compliance, Enforcement and Collection from the current one percent transfer authority to five percent. This provides the Service with much-needed flexibility to respond to demands to refocus its resources during the coming year to solve problems that we today cannot foresee. The problem with the W-4 form is a case in point. It was difficult to foresee the public perception and negative reaction to the original W-4 release, which was faithful to the 1986 Act. When something like this occurs, the Service needs to reallocate resources immediately to solve the problem. The current one percent transfer authority is inadequate. In light of the demands imposed by tax reform implementation, five percent authority is surely reasonable.

Secondly, all agree that there is room in improving taxpayer services, most specifically telephone and walk-in contacts. We suspect that there may be a classification problem. A telephone technical operator at the Internal Revenue Service certainly requires more knowledge and skill than his or her counterpart handling routine information in a more circumscribed field. We recommend a study of all Internal Revenue Service personnel classifications to insure that the pay assigned attracts persons qualified to handle the responsibilities.

The Tax Reform Act for all of its simplification is also complex, and its proper implementation critical to the long-term credibility of our self-assessment system. Much needs to be done to educate the public by information releases, earlier release of regulations, forms, instructions, and public announcements. This also necessarily means expansion of taxpayer services even more than past years. The workload placed on taxpayer services is but one indication of what we anticipate being an even larger demand next spring, in order to deal with the first tax reform filing year.

Thirdly, we are strongly supportive of the Service's long-term computer project to have an entirely new, up-to-date computer system on line by 1995. There is nothing more important to the long-term viability of our tax system than for the Service to have a really first-rate computer system. It is extremely important that this request for funds be granted.

Biennial Budgets and
Separate Treasury Appropriations

The administration of the tax system, a difficult and demanding job under the best of circumstances, is made even more demanding by the complexity and tardiness of the budget process.

The last time the Internal Revenue Service consistently had an approved budget in place prior to the start of a fiscal year was 1976. The process has deteriorated during the intervening years to the point that since 1980, the IRS has "functioned" on the basis of continuing resolutions. No responsible business and few units of state or local

government would condone operating without a budget. The failure of Congress and the President to produce a timely budget fosters inefficiency, uncertainty and a lack of accountability among those responsible for achieving tax compliance goals and objectives.

The Internal Revenue Service is particularly affected by the inefficiencies resulting from the perennial delay in the annual budget cycle. The Service's budget is largely devoted to nondiscretionary spending. Returns must be processed when received. Computer matches must result in inquiries to taxpayers in a time period that permits the accounts adjustment cycle to be completed before the next filing season. Examinations and collection activity must be commenced, at whatever level that activity is ultimately to be authorized, in a time period that permits completion of the examination and collection activities within the relevant statutes of limitation. A failure to take timely action may cause a much greater loss later, either in the form of costly corrective actions or in permanently foregone revenues.

In addition, the IRS budget must provide for purchasing and learning how to use computer equipment and systems capable of processing billions of pieces of paper and millions of electronic submissions. This cannot reasonably be handled under last-minute continuing resolutions.

Even if delay were eliminated, these programs cannot be handled on a year-to-year basis. A number of states use biennial budgeting without any loss of desirable legislative control over the direction of state agencies. Congress should consider a biennial budget for the IRS. An alternate would be an annual budget for the IRS which is one year ahead.

This Subcommittee, as part of its oversight responsibility, may wish the IRS to conduct its own study and provide the subcommittee with the best information that is available, estimating savings and program improvements to be expected from a biennial or a year-in-advance budget.

The Subcommittee should also consider whether it is possible to separate the appropriation for the Treasury Department from the appropriation for the Post Office. The Post Office has a large, politically strong constituency, and a reputation for overspending its budget. We understand that, when this occurs, other government entities within the same budgeting unit often bear the principal brunt of the necessary reallocations of funds. Maintaining a steady and adequate financial base for the IRS is too important to place it at the risk of diversion of its funds to another major Department.

In conclusion, we strongly applaud the Commissioner and the 100,000 employees of the Internal Revenue Service for carrying out perhaps the single-most important government function effectively, efficiently and with professionalism and dedication to public service under too limited resources.

Thank you, Mr. . Chairman, for this opportunity to prevent these views on behalf of the American Bar Association. The ABA and its Section of Taxation stand ready to provide any assistance within our capabilities to you in your consideration of these important subjects.

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Chairman PICKLE. I thank you and I have noted your recommendations in the three areas. We appreciate your testimony.

Mr. JONES. Thank you.

Chairman PICKLE. Now, Mr. Skadden, representing the CPA group.

STATEMENT OF HERBERT J. LERNER, CHAIRMAN, FEDERAL TAXATION EXECUTIVE COMMITTEE, PRESENTED BY DONALD H. SKADDEN, VICE PRESIDENT—TAXATION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. SKADDEN. Thank you, Mr. Chairman. I am here to deliver the testimony of Herbert J. Lerner, chairman of our executive committee, who is out of town.

Our AICPA, as has John Jones, ABA Tax Section, long advocated appropriate funding for the IRS. In fact, our two groups recently joined in the funding of a major study by the American Enterprise Institute dealing with the financing of the IRS, and a great deal of our testimony today is based upon that study.

There is no question that non-compliance is still a significant problem. We do think it is related to the number of audits, percent of audits. Our study went back a few years further than the earlier comments today. The overall percentage of tax returns audited in 1964 was 5.12 percent, in 1986 1.14 percent. We are most concerned that this is inadequate to deter those taxpayers who want to participate in the audit lottery.

There have various estimates as to how much additional money spent in the IRS would bring in additional revenue. Our study indicates that for each additional dollar spent on examinations revenues would be increased from $4 to $7.

As noted in several past annual reports of the Commissioner of Internal Revenue the IRS budget itself has not changed significantly in over the past 40 years as a percentage of collections. It has been approximately one-half of 1 percent of the revenue collected. In fact, when you look at IRS resources, they more likely have fallen relative to workload as measured by complexity of the tax laws, number of returns, and requests for taxpayer services.

We believe that a further increase in the budget and-or allocations to the IRS is warranted and we suggest several ways that compliance and operational efficiency could be improved. We recommend expanding allocations to finance increase in examination activity, especially for those receipts or deductions that can be verified only through audit process.

Furthermore, collections and other costs associated with expanded examinations should be fully budgeted. This in itself will serve to improve taxpayer perceptions of the system and should have a positive effect on taxpayer compliance.

Second, the Service should continue to improve the ways in which it provides information to taxpayers, and it should better coordinate activities with foreign, state and local governments.

Third, the budget process for the IRS should be changed to provide for long-term comparisons of benefits and costs. The current process discourages improvements that entail current costs that

provide long-term benefits. Capital budgeting should be utilized more efficiently.

Fourth, a longer-term planning cycle for administrative agencies is needed, particularly through the selective use of multi-year budgets. Historically, each year's proposed budget goes through so many changes that staffing requirements are made uncertain, thereby hampering recruiting, delaying operational planning, and resulting in no long-term organizational plan being developed.

We also believe that the Commissioner, Associate Commissioners, and Assistant Commissioners should be given greater flexibility to allocate resources. This is essential in hiring the necessary qualified personnel in key functional and geographic areas.

The IRS is presently unable to offer competitive salaries to CPA's in areas where such individuals could serve specialty needs, and with the emphasis on tax accounting oriented provisions in the 1986 Act this shortcoming will take on great significance in respect to the rulings and regulations process where CPA's are now precluded from effective public service. The Service also needs greater flexibility to hire computer programmers and seasonal worker in some Service Centers.

I would insert just one additional point. We could not agree more, Mr. Chairman, with your comments on the importance of improved taxpayer services. One of your colleagues, Congressman Flippo, recently commented that for vast numbers of our citizens the IRS is the Government and what they think of the IRS impacts their interaction and feeling for the entire Government structure.

We appreciate the opportunity to be here today and we will be glad to answer any questions.

[The statement of Mr. Lerner, as delivered by Mr. Skadden, follows:]

Statement of Herbert J. Lerner, Chairman, Federal Taxation Executive Committee, American Institute of Certified Public Accountants

I am Donald H. Skadden, Vice-President-Taxation of the American Institute of Certified Public Accountants. I appear today to deliver the testimony of Herbert J. Lerner, chairman of the Federal Taxation Executive Committee of the AICPA. The AICPA represents over 240,000 CPAs, many of whom work with the tax laws on a daily basis. The AICPA has long advocated appropriate funding of the IRS.

Currently, the IRS is operating with a fiscal 1987 budget of $4.44 billion, an increase of $826 million over fiscal 1986. For 1988 the President has requested a budget of $5.07 billion for the Service. The Administration expects that this $624 million increase in funding will boost revenue collections in fiscal 1988 by $2.4 billion. This requested increase would allow for the hiring of an additional 9,463 employees by the Service.

The AICPA recognizes that the enforcement capability of the Service has been enhanced over the years, through improvements in computer technology, increased information reports, and increases in and reallocation of personnel. However, along with an expanded capacity to detect underreporting of income, the IRS has reported a lower audit rate for certain classes of taxpayers and for certain deductions and income sources that are not subject to either withholding or information reporting.

Noncompliance still appears to be significant (particularly in the so-called underground economy) and has more than likely been encouraged by recent declines in the percentage of returns that are audited. The overall percentage of income tax returns audited has dropped from 5.12% in 1964 to 1.14% in 1986. However, there is a higher rate for individual returns which have substantial amounts of sheltered income or other bases which indicate underreporting of tax liability. These rates may be inadequate to deter those who want to participate in the audit lottery.

In the past few years, the IRS has suffered from numerous problems including: when and how an antiquated computer system will be replaced; delays in mailing refund checks; improper posting of return data; increases in accounts receivable; and, the lack of a firm, long-term budget by which to plan.

There are various estimates as to how much revenue the IRS could produce as a result of increasing the budget allocations. The AICPA Tax Division and the Tax Section of the American Bar Association jointly sponsored an independent study conducted by the American Enterprise Institute, regarding the relationship between IRS expenditures and additional revenues. The results of the study clearly support the general proposition that for every additional dollar spent on examinations, revenues would be from four to seven dollars.

As noted in the Annual Reports of the Commissioner of Internal Revenue, the IRS budget has not changed significantly over the past 40 years as a percentage of collections -- approximately .5%. In fact, IRS resources have more than likely fallen relative to its workload, as measured by the complexity of the tax laws, number of returns and requests for taxpayer service. Although the Service has seen its budget allocations increase in recent years, the expanding role of the IRS has necessitated that these increases be spent on new and more efficient enforcement projects.

We believe that a further increase in the budget and/or allocation to Internal Revenue Service operations is warranted and emphasize the following methods -- recommended in the referenced study -- for improving compliance and operational efficiency.

- Expanded allocations should be used in part to finance an increase in examination activity, especially for those receipts or deductions that can be verified only through the audit process. Furthermore, collections and other costs associated with expanded examinations should be fully budgeted. This, in itself, will serve to improve taxpayer perceptions of the system and should have a positive effect on taxpayer compliance.

- The Service should continue to improve the ways in which it provides information to taxpayers and to better coordinate activities with foreign, state, and local governments.

- The budget process for the IRS should be changed to provide for long-term comparisons of benefits and costs. The current process discourages improvements that entail current costs that provide long-term benefits. Capital budgeting, for such items as computer hardware, should be utilized more effectively.

- A longer-term planning cycle for administrative agencies is needed, particularly through the selective use of a multiyear budget. Historically, each year's proposed budget goes through so many changes that staffing requirements are made uncertain thereby hampering recruiting, delaying operational planning, and resulting in no long-term organizational plan being developed.

We also believe that the Commissioner, Associate Commissioners, and Assistant Commissioners should be given greater flexibility to allocate resources. This is essential in hiring the necessary qualified personnel in key functional and geographical areas. The IRS is presently unable to offer competitive salaries to CPA's in areas where such individuals could serve specialty needs. And with the emphasis on tax accounting-oriented provisions in the 1986 Act, this shortcoming will take on greater significance in respect of the rulings and regulations process where CPA's are now precluded from effective public service.

The Service also needs greater flexibility to hire computer programmers and seasonal workers in some service centers.

These shortcomings should be remedied.

We appreciate the opportunity to provide this testimony and would be pleased to respond to any questions you might have.

* * *

Chairman PICKLE. Thank you very much, Mr. Skadden.

Now we will ask Mr. Hoffman for his statement.

Mr. Primoff, do you both have statements to make?

Mr. PRIMOFF. No. Mr. Hoffman will read the statement and we will both answer the questions.

Chairman PICKLE. All right. Mr. Hoffman?

STATEMENT OF ARTHUR S. HOFFMAN, CHAIRMAN, TAX DIVISION, NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOMPANIED BY WALTER M. PRIMOFF, DIRECTOR OF TAX POLICY

Mr. HOFFMAN. Thank you, Mr. Chairman.

Voluntary tax compliance requires a competent and efficient IRS. Taxpayers need the timely issuance of regulations, examinations must be handled knowledgeably and expeditiously, and above all taxpayers must perceive the Service as fair and objective. For this reason we strongly oppose, by the way, the establishment of a trust fund which was financed by interest and penalties to fund the service.

Such an approach we felt would have cost the Service's vital objectivity. Nonetheless, the Society considers that adequate funding of the Internal Revenue Service is indispensable to the fair and efficient operation of the tax system and we believe that the repute of all of those who participate in making the system work—that is tax practitioners such as ourselves, the Internal Revenue Service, and Congress—is at stake.

Mr. Schulze expressed concern about the 1988 tax season and we believe there is very good reason to be concerned. We think the public is in for a number of surprises and is going to need help. The proposed IRS budget for fiscal year 1988 embodies a substantial increase above that for the current year. We strongly support the increase.

We also support the request for the authority to transfer 5 percent of the appropriations between the segments of the budget. In our opinion, past budget constraints have harmed the ability of the Service to perform its many important functions.

We recognize that the Service is processing returns and issuing refunds at a record rate. Nonetheless we view it as having a far more comprehensive role in our society. The self-adopted mission statement of the IRS prescribes the standards for measuring its performance.

It is a wonderful statement. It speaks about encouraging the highest degree of voluntary compliance and advising the public of rights and responsibilities and make for proper administration and enforcement of the tax laws. We enthusiastically endorse these goals and we believe that Congress should provide the funds needed to accelerate the Service's progress towards achieving them.

We have some specific observations. As to personnel, the Service must be put into a budgetary position where it can compete with the professions for the attorneys and accountants and computer specialists and other skilled technicians. It must pay them, it must train them, and it must retain them.

Without a quality staff, a pipeline filled with intelligent and motivated people, the above goals which we so admire are unattainable. The answer is not merely to budget for the hiring of several thousand additional agents. They must be trained on a level comparable to tax professionals in the private sector. The GAO's testimony discussed the shortcomings of the training of its agents.

We recommend that the Service be placed in a financial position to hire outstanding graduates and outstanding professional lecturers to train them on technical subjects and research techniques. It is not only the "Big 8" that was mentioned before that is in competition for these people. Most firms have been outbidding the IRS and providing better training.

The accounting and legal professions have invested substantial resources in high quality tax training and the Service could make use of these educational materials and outstanding discussion leaders wherever possible. We welcome their inquiries.

As to taxpayer service, the IRS should not be obliged to cut back critical services. For example, teller windows at district offices were closed in 1986 as a cost-cutting measure. By what rationale can this action be reconciled with the goals of the IRS Mission Statement? If this is due to budgetary constraints then the budget is deficient.

The GAO reported on errors in advice to taxpayers. Obviously, something should be done: more training; the hiring of retired practitioners, perhaps; whatever is necessary to reinstate reliability in a service vital to the fostering of public confidence. The funds required should be provided.

A vital factor in reaching an understanding with the Service when the normal processes prove inadequate has been access to a Problems Resolution Officer. It has been the recent experience of practitioners that the function is bogged down by a deluge of cases and inhibited by personal turnover. We believe that increasing the numbers and competence—and I stress competence—of regular agents who can resolve issues now being referred to Problems Resolution would revitalize this important service.

As to examinations, the most striking statistic by which the public measures the IRS is the percentage of returns which are examined. We do not have to belabor the point that a decline from about 5 percent in 1964 to about 1 percent in 1986 must raise the presumption in the minds of an average taxpayer that chances are in his favor that he will not be audited and will not have to defend a position which is arguable. In addition, in that same period few revenue agents were added to the roles and many agents were committed to special assignments such as the time consuming process of examining tax shelters. In addition, as tax practitioners we can state that the experience level and training of agents, especially in light of the veritable flood of new tax legislation of recent years appears to have diminished. We do not believe that any shortfall in the numbers of examinations and the technical ability of agents can be solved merely by equipping agents with portable computers. The productivity of such a device will depend upon the capability of the user. This

brings us back to the point that quality and training must be enhanced by sufficient budgetary allotment.

We find that inadequate funding manifests itself in very unfortunate ways, and this has to do with taxpayer perceptions. For example, one response to the criticism borne by the IRS for the decline in the percentage of examinations is the sudden emphasis upon conducting personal interviews of taxpayers even though they are represented by an attorney, CPA or enrolled agent.

The Society has questioned the practice, and you, Mr. Chairman, requested that the Commissioner reconsider this policy. We understand the Service is doing so. We are of the opinion that the Service is incorrect in their belief that the procedure would facilitate examinations and make them more efficient.

Quite the contrary. We believe that the resources of the Service would be strained by conversion of routine examinations into confrontations on issues of taxpayer's rights. We urge this subcommittee to consider the subject in the course of these proceedings.

Our regulatory projects, the Tax Reform Act of 1986, coming on the heels of monumental tax legislation over the preceding decade, has imposed a regulatory burden upon the Service which is herculean. More than 400 regulations projects are now outstanding.

Tax practitioners and their clients are in the dark about the Service's interpretations of many provisions affecting common transactions. As a result, the tax law in many areas is uncertain. Consequently, a basic element of the Mission Statement is unfulfilled: To "achieve the highest degree of voluntary compliance in accordance with the tax law and regulations." We ask, what regulations?

We recommend to the subcommittee that serious consideration be given to enhancing the capability of the Service to issue regulations on a more timely basis and we urge the Service to hire attorneys, CPA's, actuaries—whoever is best suited to break the logjam.

One last general observation: The Tax Reform Act of 1986 provides that most pass-through entities, partnerships, S corporations, trusts and estates must adopt a calendar year. Organizations, including the AICPA and our Society have brought to the attention of Congress the workload crisis that is certain to arise. The crisis will impact upon the tax profession and upon the Service.

Earlier Commissioner Gibbs speculated that late filing this year was caused by late information to prepare such returns. Wait until next year when former fiscal year taxpayers must file two sets of tax returns. Then you are going to see the extensions multiply.

Whether the IRS can process the returns is not the issue. It may do so but it is bound to sacrifice other vital functions in the normal course of events. Accordingly, we recommend that the Subcommittee consider the amount of additional appropriations which will be needed for the 1988 tax season if the effective date of the provision is not deferred for one year as most organizations have suggested.

In summary, we believe that it is in the national interest for the Service to achieve the goal set forth in its Mission Statement and

for Congress to promote the means to do so. We agree with you, Mr. Chairman, that the Service should not become a faceless collection agency.

Thank you very much.

[The statement of Mr. Hoffman follows:]

Testimony of
Arthur S. Hoffman
Chairman of the Executive Committee
of the Tax Division
of the
New York State Society of Certified Public Accountants

I am Arthur S. Hoffman, Chairman of the Tax Division of the New York State Society of Certified Public Accountants. With me is Walter M. Primoff, the Society's Director of Tax Policy. The Society has a membership of 29,000 CPAs, many of whom are "tax practitioners"; professionals who have devoted their careers to assisting this country to achieve the best level of voluntary tax compliance of any nation in the world.

We greatly appreciate the opportunity to testify before you today. As the intermediary between millions of taxpayers and the IRS, its budget is a matter of vital concern to us. The quality of our work depends to a large degree upon the performance of the Internal Revenue Service. We interrelate with the Service, and to some extent, we are interdependent.

Voluntary tax compliance requires a competent and efficient IRS. Taxpayers need the timely issuance of regulations. Examinations must be handled knowledgeably and expeditiously. Above all, taxpayers must perceive the IRS as fair and objective. For this reason, we strongly opposed the establishment of a trust fund financed by interest and penalties to fund the Service. Such an approach would have cost the Service its vital objectivity.

However, the Society considers adequate funding of the Internal Revenue Service to be indispensable to the fair and efficient operation of the tax system. We believe that the repute of all of those who participate in making the system work--tax practitioners, the IRS and Congress--is at stake.

The proposed IRS budget for fiscal 1988 embodies a substantial increase above that for the current year. We strongly support this increase.

In our opinion, past budget constraints have harmed the ability of the Service to perform its many important functions. In making this observation, we do not level criticism at the agency; inadequate funding would impact adversely upon the operations of any organization.

We recognize that the Service is processing returns--
and issuing refunds--at a record rate. Nonetheless, we view it as having a far more comprehensive role in society. The self-adopted Mission Statement of the IRS prescribes the standards for measuring its performance:

- Encourage and achieve the highest degree of voluntary compliance,
- Advise the public of their rights and responsibilities, and
- Do all things needed for the proper administration and enforcement of the tax laws.

We enthusiastically endorse these goals. Each is indispensable to accomplishing the Services declared paramount objective: to warrant "the highest degree of public confidence in our integrity, efficiency and fairness. We believe that Congress should provide the funds needed to accelerate the Service's progress towards achieving these goals.

In the context of the higher budget proposal, and to encourage its adoption, we have specific observations in several areas:

- Personnel
- Taxpayer service
- Examinations
- Regulatory projects

Personnel

IRS must be put into a budgetary position where it can compete with the profession for attorneys, accountants, computer specialists and other skilled technicians. It must pay them, train them and retain them. Without a quality staff, a pipeline filled with intelligent, motivated people, the above-stated goals are unattainable.

The latest General Accounting Office survey, which found a high percentage of wrong answers to taxpayers' inquiries, is damaging to public confidence and reflects upon the availability of experienced and trained personnel to perform vital public relations (and revenue raising) functions.

The answer is not merely to budget for the hiring of several thousand additional agents. They must be trained, on a level comparable to tax professionals in the private sector.

We recommend that the Service be placed in a financial position to hire outstanding graduates, and outside professional lecturers to train them on technical subjects and research techniques. The accounting profession has invested substantial resources in high-quality tax training. The IRS should make use of these educational materials and outstanding discussion leaders wherever possible.

Taxpayer Service

IRS should not be obliged to cutback critical services. For example, teller windows at district offices were closed in 1986 as a cost-cutting measure. By what rationale can this action be reconciled with the goals of the IRS Mission Statement? If this is due to budgetary constraints, then the budget is deficient. We referred to the GAO report. Obviously, something should be done: more training; the hiring of retired practitioners; whatever is necessary to reinstate reliability in a service vital to the fostering of public confidence. The funds required should be provided.

A vital factor in reaching an understanding with the Service when the normal processes prove inadequate, has been access to a Problems Resolution Officer. It has been the recent experience of practitioners that the function is bogged down by a deluge of cases and inhibited by personnel turnover. We believe that increasing the numbers and competence of agents who can resolve issues now being referred to Problems Resolution would revitalize this important service.

Examinations

The most striking statistic by which the public measures the IRS is the percentage of returns which are examined. We need not belabor the point that a decline from about five
percent in 1964 to about one percent in 1986 must raise the presumption in the mind of the average taxpayer that chances are in his favor that he will not be audited and have to defend a position which is arguable. In addition, in that same period, few revenue agents were added to the rolls, and many agents were committed to special assignments, such as the time-consuming process of examining tax shelters.

In addition, as tax practitioners, we can state that the experience level and training of agents, especially in light of the veritable flood of new tax legislation in recent years, appears to have diminished.

We do not believe that any shortfall in the numbers of examinations and the technical ability of agents can be solved merely by equipping agents with portable computers. The productivity of such a device will depend upon the capability of the user.

This brings us back to the point that quality and training must be enhanced by sufficient budgetary allotment.

We find that inadequate funding manifests itself in unfortunate ways. For example, one response to the criticism borne by the IRS for the decline in the percentage of examinations is a sudden emphasis upon conducting personal interviews of taxpayers even though they are represented by an attorney, CPA or enrolled agent. The Society has questioned the practice, and Chairman Pickle requested that the Commissioner reconsider this policy. We understand that the Service is doing so. We are of the opinion that the Service is incorrect in their belief that the procedure would facilitate examinations and make them more efficient; guite the contrary. We believe that the resources of the Service would be strained by conversion of reactive examinations into confrontations on the issue of taxpayers' rights. We urge the subcommittee to consider the subject in the course of these proceedings.

Regulatory Projects

The Tax Reform Act of 1986, coming on the heels of monumental tax legislation over the preceding decade, has imposed a regulatory burden upon the Service which is herculean. More than four hundred regulations projects are now outstanding. Tax practitioners and their clients are in the dark about the Services' interpretation of many provisions affecting common transactions. As a result, the tax law in many areas is uncertain. Consequently, a basic element of the Mission Statement is unfulfilled: To "achieve the highest degree of voluntary compliance in accordance with the tax law and regulations."

We recommend to the subcommittee that serious consideration be given to enhancing the capacity of the Service to issue regulations on a more timely basis. And, we urge the Service to hire attorneys, CPAs, actuaries--whomever is best suited to break the logjam.

One last general observation: The Tax Reform Act of 1986 provides that most pass-through entities, partnerships, S Corporations, trusts and estates must adopt a calendar year. Organizations, including the American Institute of CPAs and the New York State Society of CPAs have brought to the attention of Congress the workload crisis that is certain to arise. The crisis will impact upon the tax profession and upon the Service. Whether the IRS can process the returns is not the issue. It may do so, but it is bound to sacrifice other vital functions in the normal course of events. Accordingly, we recommend that the subcommittee consider the amount of additional appropriations which will be needed for the 1988 tax season, if the effective date of the provision is not deferred for one year, as most organizations have suggested.

Our comments have been limited only by time. There are many other common situations where lack of resources create administrative difficulties for tax practitioners and the IRS itself. We would be happy to submit details to your staff.

In summary, we believe that it is in the national interest for the Service to achieve the goals set forth in its Mission Statement, and for Congress to promote the means to do so. We agree with you, Mr. Chairman, that the Service should not become a faceless collection agency.

Thank you once again, Mr. Chairman, for the privilege of testifying.

Chairman PICKLE. Thank you, Mr. Hoffman.
Now we have Mr. Tobias.

STATEMENT OF ROBERT M. TOBIAS, PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Mr. TOBIAS. Thank you, Mr. Chairman.

I very much appreciate being here and thank you for your leadership. This Committee has been in the forefront, particularly in 1985, in pointing out to the public that the Internal Revenue Service failed, and in large part because this Administration starved the Internal Revenue Service for resources.

I am pleased that this Committee has fulfilled its function of examining whether or not the Congressional policies that have been enunciated have been carried out. I agree with one of my colleagues on this panel that we are now at a very critical juncture in the IRS when once again the help of this Committee is needed.

It seems to me that the Internal Revenue Service is searching for a goal by which to define itself. Is it cases closed, money collected, the number of telephones that are answered? Commissioner Gibbs took a shot at trying to define the IRS in the five-year plan that he produced as a result of last year's continuing resolution. It has been submitted to the Appropriations Committee.

It was submitted on April 2, but this five-year plan, I think, really did not get the job done. Because if you look at that plan it still does not have a cohesive goal that is defined, a specific goal by which all of the programs may be judged.

In other words, how much money do we spend on this, how much money do we spend on that? It seems to me that the goal that we ought to have, the goal that we ought to judge the Internal Revenue Service by is where are they in terms of voluntary compliance.

It seems to me that every program, every action, every dollar expended should be evaluated in terms of whether or not it increases voluntary compliance. Currently that voluntary compliance is projected at 81.6 percent with a projected voluntary compliance gap of over $100 billion.

But the significance of that gap and the significance of the percentage, in my view, is that if it continues to widen we will have fewer and fewer people who voluntarily pay, necessitating an ever larger army in the Internal Revenue Service to maintain that voluntary compliance rate.

At some point the Congress will say no, we cannot have more people to enforce the law, and when that occurs we will not have the income tax system as a method of raising money in this country.

If we apply the voluntary compliance goal and look at the 1987 supplemental budget request for $200 million, we see that the Internal Revenue Service needs that money. They need the money for increased positions and exam and collections because it means that the current percentage of audits will increase and the historical low will be turned around. It also means that we will have more people in collection out on the streets collecting the $45 billion that is identified owed and not being paid.

I think that the $200 million is also important for tax reform implementation. There has been much made about the need for new regulations and the implementing regulations, and I think that is true. But I suggest that the Internal Revenue Service is shortchanging the training of the existing IRS personnel on the Tax Reform Act.

Historically what the IRS has done is waited a couple of years to do training until the revenue officers or revenue agents are actually handling cases. I think that in light of the massive reformed that occurred last year that every single employee who deals with the public has to be knowledgeable and has to know what happened last year so that they can communicate effectively and knowledgeably with the public.

In similarly applying the test to 1988 we see that the additional collection and exam positions are needed and we need the additional positions to expedite returns processing, but I think that if we applied the voluntary compliance rate we would see that we also need additional positions in taxpayer service, because without those people in taxpayer service answering questions accurately, quickly and competently, we will have a further erosion of that voluntary compliance rate.

Frankly, Mr. Chairman, the additional positions in taxpayer service could be funded out of the amount of money that OMB forced the IRS to absorb this year, some $158 million. If you look at the numbers that came up in the budget closely, what you see is that the IRS actually asked for some 11,372 positions and OMB said, okay, you can have 9,500 positions, not 11,372 positions, and you have to absorb some $158.9 million.

We know that when you have to absorb $158.9 million that you are not going to get the revenue projections that you have made or you are not going answer the telephones that you project that you are going to be answering. So what we are urging is that each of these initiatives be consistent with increasing voluntary compliance and increasing the quality of the Internal Revenue Service.

I might just add one further thing, Mr. Chairman. I do not think that you can enhance the quality or enhance the performance of the IRS without enhancing the people who work there. As so many people have testified already this morning, the turnover rate, the inability to attract and retain and train and motivate those who are currently in the IRS is indeed a crisis.

When you have a 17 percent turnover in a Service Center, when you have a 91 percent turnover of seasonal employees, you cannot hope to have a smooth operation. I think that the Internal Revenue Service has not made one mention of that in its testimony. You have heard much of it from those who deal with the Internal Revenue Service, and certainly as the President of the Union that represents them, I can assure you that it is a very, very serious problem that has to be addressed.

Thank you very much, Mr. Chairman.

[The statement of Mr. Tobias follows:]

STATEMENT
OF
ROBERT M. TOBIAS
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

Mr. Chairman and Members of the Subcommittee:

I am Robert M. Tobias, National President of the National Treasury Employees Union. NTEU is the exclusive representative of over 120,000 Federal workers, including virtually all employees of the Internal Revenue Service. I am accompanied today by Patrick Smith, NTEU Director of Legislation, and Paul Suplizio, legislative consultant.

On behalf of the men and women who collect the revenue of the Federal government, I am pleased to appear before you to present our recommendations on the Administration's budget request for FY 1988.

Our nation's tax administration system remains under great strain, with a 20 percent non-compliance level, over $100 billion in uncollected taxes, and inadequate taxpayer services needed to instill public confidence. Nevertheless, under your leadership, Mr. Chairman, and that of the Subcommittee during the past two critical years, IRS has made progress in dealing with its most pressing problems and it is now possible to turn our attention to steps to promote the long-range health of the system.

Establish a Ninety Percent Compliance Objective

Of these measures, none is more important than for Congress to establish a ninety percent compliance level as a national objective. This objective would set the standard against which steps to strengthen the effectiveness of IRS should be measured. The present 80 percent compliance level is by no means foreordained. It is a creature of neglect, of a decade of declining enforcement that allowed nonfilers and underreporters, tax shelter operators and other abusers of the system to flourish. As the Yankelovich public opinion survey confirmed, the principal motivation for tax cheating is that others are getting away with it, and the principal deterrent to evasion is actual detection coupled with the fear of detection. By strengthening enforcement and taxpayer services, we can affect public attitudes and make a ninety percent level of voluntary compliance a reality.

FY 1988 Appropriation

With a few major exceptions, the Administration has proposed a budget for IRS in FY 1988 that is both realistic and responsive to the need to halt the decline in voluntary compliance and collect the revenue due the Federal government. The budget calls for an increase of $624 million and 9,400 average positions over the FY 1987 level.

The budget claims that an additional $2.4 billion will be collected in FY 1988 alone, but this will occur only if the program improvements are fully funded, and they are not. OMB has imposed an absorption of $159 million, which will result in 1,400 positions going unfilled. As this is a 12.8% reduction in the new revenue initiatives, approximately $300 million less revenue will be collected. We strongly urge

Congress to restore the $159 million by providing a total of $5.2 billion and 112,051 average positions for IRS in FY 1988.

The budget continues the Examination Initiative launched last year by funding 3,000 positions over and above the 2,500 positions provided last year. With these resources, IRS expects to increase the number of examinations by more than 600,000 over the 1986 level. This will raise audit coverage from 1.12 percent in FY 1986 to 1.61 percent in FY 1988.

A Tax Shelter Initiative consisting of $38.8 million and 822 average positions will assist in clearing up the backlog in Appeals and Tax Litigation. However, this amount is woefully insufficient considering the backlog of cases awaiting settlement in Appeals and docketed before the Tax Court. There are now over 158,000 such cases, about one-third of them tax shelters, in inventory. Hard on their heels are another 400,000 cases moving through the pipeline to Appeals for dispute resolution. NTEU has pointed repeatedly to the growing backlog in Appeals and before the Tax Court, and we have urged the Administration to provide sufficient resources to clear up this backlog. Our pleas have fallen on deaf ears and, as a result, inventories have become totally unmanageable. IRS has been forced to announce a humiliating settlement program that will let tax shelter investors off easy while honest taxpayers are left holding the bag for hundreds of millions of dollars. Sending a signal to the American public that tax cheats who've been caught are going to be let off with a mild slap on the wrist simply debases the spirit of voluntary compliance. The average amount owed on a pre-1982 tax shelter case is $25,000. The question that must be asked is, how much is IRS offering to settle these cases for? Congress should require a full accounting for the revenue loss from these settlements.

A Collection initiative will provide an additional 3,000 positions at a cost of $122 million and return $1.1 billion in FY 1988. IRS expects to settle an additional half million taxpayer delinquent accounts with these resources, reducing the overall TDA inventory from 1.9 to 1.4 million.

Taxpayer Service

The public's perception of IRS and the fairness of the tax system depends importantly on whether taxpayers can obtain assistance with their problems. Of the calls IRS receives by telephone, about one-third involve questions about tax laws, one-third are account related, and one-third are related to procedures or tax forms. Even though the Tax Reform Act doesn't become effective until next year, 31 percent of the questions this tax filing season pertain to the new tax law. In FY 1988, IRS plans to assist 42.6 million taxpayers through toll-free telephone, walk-in, and correspondence assistance -- down from 46.4 million in FY 1986. Walk-in assistance was provided to 8.1 million taxpayers in FY 1986.

IRS' planned automated Taxpayer Service system will enable assisters to access taxpayer account information in order to improve response to questions. The system will be tested in FY 1988 and implemented in FY 1989 if testing is successful. IRS has provided no justification for the reduction in the current budget from 5,696 average positions in FY 1986 to 5,395 in FY 1987. However, it proposes an increase to 5,784 average positions in FY 1988. NTEU believes that Congress should require IRS to allocate sufficient taxpayer service resources to maintain an 80 percent service level for taxpayers requesting assistance.

In 1986, the questions in GAO's survey of Taxpayer Service spanned a wide range of tax law, and 83 percent were correctly answered. This is approximately the same rate as earlier years, with the exception of 1985 when accuracy declined to 74 percent. Preliminary results for 1987 show a 78 percent accuracy rate, which is a significant decline. Moreover, 15 percent of the answers were correct but incomplete. Questions relating to recent changes in the tax law and on form W-4 were less likely to be answered correctly.

The results of GAO's 1986 survey show that IRS did not achieve the eighty percent minimum service level it established, and needs to raise the level of accuracy of its responses. We recommend that IRS improve the training and professional development of its tax assister staff, and improve access to information that will better enable them to answer tax account questions. IRS should also enhance the attractiveness of the taxpayer service career field, in order to retain experienced people and upgrade the technical proficiency of the work force.

Appeals and Tax Litigation

There are over 158,000 non-docketed Appeals and docketed Tax Court cases in inventory today, and over 400,000 returns moving through the pipeline to Appeals for dispute resolution. Despite NTEU's repeated warnings, the Administration has failed to provide sufficient resources to clear up this backlog and has allowed caseloads to become totaly unmanageable. As a result, IRS has announced a settlement policy that is both a humiliating surrender to the tax cheats of this country and a blow to our voluntary compliance system. Honest taxpayers will be left holding the bag for hundreds of millions of dollars.

The average caseload inventory per Appeals Officer stood at 63.3 in FY 1985, grew 76 percent to 111.7 in FY 1986, and is projected to be 94.9 in FY 1987 and 83.1 in FY 1988 -- provided the absorption is restored and 227 new Appeals Officers are added. Experience has shown that average caseload should not exceed 60 to be manageable.

NTEU long ago predicted, when Appeals was placed under the Chief Counsel's office, that pressure to keep Tax Court caseloads manageable would result in injudicious settlements in Appeals, and that is exactly what happened. Appeals agreement rate on docketed cases rose from 57 percent in 1981 to 83 percent in 1984. Of nondocketed cases, Appeals settled 84 percent in 1984. NTEU has questioned in the past "whether the goal of achieving a fair settlement with the

taxpayer is being supplanted by the interest of the Chief Counsel in keeping litigation caseloads manageable." With the recent announcement of a lenient settlement policy, IRS seems to be saying that fair settlement doesn't count.

The backlog of non-docketed cases in Appeals will continue to grow from 50,800 in FY 1986 to 54,900 by the end of FY 1988 -- even with the planned increase in staff. In Tax Litigation, the inventory docketed before the Tax Court will also keep growing from 98,000 in FY 1986 to 102,400 by the end of FY 1988. These increases will occur despite the fact that nearly 38,000 more docketed and non-docketed cases will be settled in FY 1988 than in FY 1986. Clearly, the Appelate and Tax Litigation staff is being strained to the utmost and, even with the planned reinforcements, resources remain inadequate.

The logjam confronting the Tax Court is evident from the fact that case receipts exceeded case closures by more than 30,000 in FY 1985 and FY 1986. Even with additional staff to attempt to reach settlements without proceeding to trial, case receipts are projected to continue to exceed closures by 4,300 cases in FY 1987 and FY 1988. As a result, the docketed ending inventory, which stood at 82,200 cases in FY 1985 will be 101,600 cases at the end of this year and 102,400 cases at the end of FY 1988.

We strongly urge the Committee to support restoration of the full $159 million absorption required in this budget, and to direct IRS to report quarterly to the Committee its progress in reducing its Appeals and Tax Litigation workloads to manageable levels. Moreover, if expedited settlement procedures are applied, IRS should render a full accounting to the Committee of the revenue losses entailed.

Improve Recruitment and Retention of IRS Personnel

IRS employees are a dedicated and competent work force. But far too many talented and experienced workers are leaving the Service due to low pay, stressful working conditions, and the lure of attractive careers in the private sector. This Administration's downgrading the worth of Federal service has made matters worse.

Today, IRS is experiencing a brain drain of some of its most talented people. The turnover Service-wide is 11.3 percent each year. As a result, IRS is forced to spend millions to recruit and train new people -- millions that could be better utilized to pay its experienced workers well and provide them attractive careers. A revenue agent, revenue officer, taxpayer service or computer specialist requires years of professional development. If IRS is unable to produce these professionals in large enough numbers, and if they are being siphoned off to better-paying jobs in the country's accounting firms and corporate tax departments, technical competence in the Service will suffer. The most advanced computer systems will be operated inadequately. Taxpayers will not be able to get the quality of service they deserve, and the long-run health of the tax administration system will be undermined.

A few examples will serve to illustrate this point.

- Adjustment/Correspondence employees who handle taxpayer inquiries in IRS Service Centers are among the most technically proficient tax specialists in IRS. When correspondence inventories grew to abnormally high levels in 1985, IRS found itself short of competent personnel to process these inventories and had to scour its district offices to locate experienced people who could be brought into the Service Centers to handle this function.

- Computer programmers in IRS Service Centers needed to program the new Sperry computers in 1985 were insufficiently trained and inexperienced in the new COBOL language, resulting in poorly written programs that took inordinately long times to run. Because of their inexperience, programmers failed to use sufficient benchmarks separating one part of the program from another. When trouble was experienced with a program, it had to be run from the beginning rather than from a benchmark, consuming excessive amounts of time and preventing other Service Center components from having access to the computers.

- Since October, 1985 Computer Branches in Service Centers have been organized for 24-hour, 7-day week operations to forestall further breakdowns. Although management allocated sufficient staff-years for such operations, Service Centers discovered that finding qualified personnel was easier said than done. At the Philadelphia Service Center, 21 additional computer operators were to be hired for 1986. Well into the filing season, 19 of the operator positions remained unfilled despite continuing efforts to locate competent new hires. According to research by Eugene Steurele of the American Enterprise Institute, "IRS has almost no chance of hiring computer science majors out of college." IRS' Recruitment and Turnover Study (1984), found that the entry-level salary in the private sector for computer science majors with no job experience was $23,500, while government entry-level salaries were between $13,903 and $17,221. One IRS computer division had 213 employees, of whom only 4 held advanced degrees in information systems and only one held a bachelor's degree in computer science.

- Service Centers are having difficulty attracting and retaining experienced employees. To assist with the 1986 filing season, the Philadelphia Service Center hired 957 new people in January and February, almost none of whom had prior IRS experience. Whereas 55 percent of seasonal employees at all Service Centers were experienced in 1984, this number had dropped to 39 percent in 1986 and 35 percent in 1987. Only about 45 percent of Service Center workers are permanent employees, even though 58 percent of the jobs are supposed to be permanent positions. IRS recently agreed, at NTEU's prodding, to raise the ratio of permanent employees to 52 percent, but more needs to be done. In 1984, Service Centers at Atlanta, Philadelphia, Ogden, Austin, and Andover all had separation rates for their permanent workforce (excluding temporary and seasonal employees) of 9 percent and above. Austin had a 13.3 percent rate, and Andover 17 percent. All Service Centers together had a 9.5 percent separation rate for permanent employees.

According to GAO, Service Center officials attribute high turnover to "lack of part-time work and flexible work hours at the centers, job stress due to performance standards, and entry level salaries that were often lower than those offered by local fast food restaurants."

- Turnover among permanent employees in the rest of IRS is equally high. Regions collectively had an 11.4 percent separation rate in 1984, led by Southeast (12.5 percent), Southwest (14 percent) and Mid-Atlantic (14.6 percent). The average for district offices was 12.3 percent, and in the national office 9.8 percent. The Service-wide average was 11.3 percent.

- For the critical occupations of Revenue Agent, Revenue Officer, and Tax Auditor separation rates are excessive. Average rates Service-wide were 7.4 percent for Revenue Agents, 8.3 percent for Revenue Officers, and 9.3 percent for Tax Auditors in 1984. However, the average rates conceal a much deeper malaise. More experienced employees are leaving the Service than inexperienced employees. An IRS study of Revenue Agent Attrition for FY 1979 showed that voluntary separations in GS-9 through GS-13 were 63 percent of the total number of Revenue Agent quits, while the other 37 percent were in GS-5 through GS-7. The field offices with the highest quit rates of experienced agents were located principally in the Sunbelt states of the Southeast and Southwest. Inadequate salaries and production pressure are important factors in this attrition.

- IRS is increasingly unable to compete with the salary scales of the private sector in attracting quality accounting graduates. An IRS study completed in 1981 found that the average starting salary offer to Bachelor's degree candidates in accounting was $16,728. At the 50th percentile, above which 50 percent of the offers were made, the salary offer for graduates with a Bachelor's degree in accounting was $16,800. The starting salary offer at the 10th percentile, above which 90 percent of the offers were made, was $15,000. These figures compared to IRS starting salaries of $12,266 at GS-5 and $15,193 at GS-7 level. That was in 1981. The situation has worsened since then as Federal pay scales have fallen further behind the private sector.

Congressional Leadership Needed to Solve Pay and Production Pressure Problems

IRS can do little about the attractive career opportunities that abound for its skilled people in the private sector. But it does have the means, with Congressional assistance, to tackle the two main sources of high turnover: low pay and production pressure.

Congress and the Administration need to address the problem of IRS salary scales being out of line with the private sector in terms of both pay and responsibility. For too long, the Federal government has kept the upper grade of

an Internal Revenue Agent at the GS-13 level, despite the tremendous growth in complexity of our tax laws and the degree of accounting sophistication with which returns are prepared. A Revenue Agent's responsibility in auditing a complex return of a corporation or partnership today, and the commensurate skills required, are much greater than a decade ago. In order to overcome the starting salary problem, IRS has already begun to hire Revenue Agents at higher entry grade levels. If experienced agents are to be retained, it is essential that the senior grade level for a Revenue Agent be raised to GS-14.

Many of our people with highly developed tax expertise and technical skills would remain in the Service if rewarded with higher pay for their skill level. Practically the only way this can be done today is by advancing the worker into a higher grade, where positions are too few in number to give all qualified employees working at the same skill level additional pay. Advancing to a higher grade frequently means entering managerial ranks, where duties are those of a manager rather than of a skilled technician, resulting in the technical expertise of the individual not being utilized as fully as possible. What is needed is a means of recognizing with additional pay the level of technical expertise attained by IRS workers.

Accordingly, we urge Congress to authorize IRS to spend up to $50 million for a pilot program to pay a skill-level differential to employees in critical occupations with high turnover. Such pay for higher skills would be designed to offset the differential between the private sector and IRS with respect to workers with comparable skills, thereby enhancing retention. This concept has nothing to do with performance pay, which is designed to encourage superior performance but is beset with serious practical difficulties to its implementation. It is, as I say, designed to recognize the higher skill levels attained by experienced workers and required in their jobs, and to reward these skilled employees with a pay differential that would narrow the gap with the private sector and reduce the present drain in critical occupations.

The payroll system IRS employs, known as PERMITS, has resulted in an extraordinarily high number of payroll errors. At times, it has had over 15,000 errors awaiting correction. The effect is that IRS personnel do not get overtime pay until months later, savings bond deductions are never made or much more is deducted than authorized, and some people go months without receiving a paycheck. Our Chapter presidents report that PERMITS problems are among the most time-consuming issues they work on for our members.

Even today, there is little hope that we will see the huge error rate drop anytime in the near future. IRS will be a place where roughly 1 in 15 people will be improperly paid at any time. We cannot even estimate how many staff hours are lost trying to compensate for this system, but the waste is enormous. Congress should provide funds for the replacement of PERMITS, and require IRS to move promptly to resolve all payroll questions within 15 days in order to reduce the significant morale problems being created by the current system.

Service Center Operations

IRS must pay greater heed to quality control in returns processing activity. Last year, error resolution files were so large that IRS had to change its tolerance levels for clearing up these cases. This didn't reduce the volume of errors, it simply redefined the errors IRS would work to correct. Inadequate quality control and larger error resolution files lead to erroneous notices which cause grief to taxpayers, especially when they continue to receive notices because their reply is tied up in the Correspondence/Adjustment Branch. Last year, an internal IRS memorandum stated that "management review of pipeline correspondence has reflected error rates as high as 40 percent." Such conditions stem from production pressure and failure to take the time to do the job right the first time. Resources are then expended in notice review in an effort to prevent taxpayers from receiving erroneous notices.

In Service Centers, IRS is not performing the quality review required by its own manual. We strongly recommend that IRS apply the needed resources to achieve the quality standards in returns processing activities that are called for by the Internal Revenue Manual.

Key verification is one way IRS can significantly reduce errors at the point where returns information is manually transcribed by key operators into computers. Key verification entails entry of the same data by a second operator to check accuracy. Yet when GAO recommended last year that IRS perform 100 percent key verification of taxpayer entity data (name, address and identification number of the taxpayer) IRS rejected the suggestion for a more limited program tied to original entry operator error rates. Under Service Center working conditions, even the best operator can make mistakes. IRS should accept GAO's suggestion and move to one hundred percent key verification.

During 1985 and 1986, sizeable inventory backlogs were being worked by IRS Service Centers. The most significant backlogs were in adjustments/correspondence and unpostables. Another significant backlog was in Service Center Control Files, which contain block listings of documents scheduled for processing.

The adjustments/correspondence inventory consists of taxpayer correspondence and tax account adjustment requests. IRS considers a correspondence inventory manageable when no more than 20 percent of the controlled cases are 45 days old or older. Throughout 1985 and 1986, unmanageable inventory levels accrued as workers were unable to keep up with the number of new cases being generated. IRS then reduced its correspondence inventories by reducing the number of IRS-initiated tax-account adjustments by raising various tolerances.

All told, raising tolerances cost IRS $200 million in revenue in FY 1986, with most of the loss coming in the area of the Federal Tax Deposit system. We believe that the Subcommittee should require IRS to re-establish these tolerances at realistic levels that do not prejudice the collection of revenue or undermine taxpayer confidence in

the system. IRS cannot solve its problems by waving a magic wand and pretending the workload has been reduced when it isn't.

The unpostables inventory consists of transactions on magnetic tape that will not post to taxpayer accounts at the National Computer Center. IRS considers an unpostable inventory manageable if cases 3 weeks old or older do not exceed 20 percent of the unpostable inventory. At the end of January, 1987 the unpostables inventory stood at 661,000 cases and was not at a manageable level in three Service Centers: Atlanta, Philadelphia, and Brookhaven. The adjustments/correspondence inventory stood at 497,000 cases nationwide. If correspondence and unpostable inventories are not brought down and kept at manageable levels, taxpayers will experience delays in getting their inquiries answered and their transactions posted to the master file. Therefore, we recommend that the Subcommittee continue to closely monitor IRS performance in these two critical area.

In the ADP program, IRS significantly expanded its computer capacity through a multi-million dollar procurement in 1986. Nevertheless, we would like to raise certain cautions. Probably the most important system for answering taxpayer inquiries and processing refunds and adjustments is the Integrated Data Retrieval System (IDRS), which gives on-line access to IRS computers. IDRS inquiries pass through computers known as front-end processors, and IRS is in the process of replacing these. If these computers have insufficient capacity, or should prove unreliable (there is only one per Service Center), we could again experience delays in answering taxpayer inquiries, making account adjustments, and processing refunds. All front-end processors are scheduled for replacement this summer, due to ageing of current equipment. Reliability of the new machines and their impact on real-time availability of mainframe computers will have to be closely monitored.

IRS plans to bring a full state-of-the-art system, known as the Tax System Redesign, on line in FY 1993. TSR is supposed to provide the modern technology needed to carry IRS into the 21st century. In view of experience with the Service Center Replacement System introduced in 1985, the Subcommittee should closely monitor IRS' ADP program to ensure that further computer acquisitions are properly planned and implemented. It is especially important that training of Service Center personnel be planned for and introduced soon enough to be effective.

Examination

The Examination Division is the backbone of IRS' efforts to achieve a high degree of voluntary compliance with the tax laws. Between 1976 and 1986, non-compliance grew while audit coverage fell from 2.6 to 1.1 percent. There is little doubt that IRS is now conducting far too few face-to-face audits. There are many issues, particularly those associated with underreported income and questionable deductions, that can be resolved only by meeting with the taxpayer. Such audits have a salutary effect upon compliance. The taxpayer will frequently discuss the audit with his friends and associates, and he may take greater care in his future filings.

Nothing would be more conducive to raising compliance than to increase audit coverage to above two percent. Fortunately, Congress and the Administration have embarked on this course and have shown a willingness to provide the necesary resources. The real problem is whethr IRS will be able to attract and retain the high-calibre people needed in Examination. Being able to compete for the best accounting graduates, and providng incentives to make the Service an attractive career, are fundamental to ensuring that the additional resources will be used effectively.

IRS has recently issued personal computers to Revenue Agents under the Automated Examination System, and this is a major step forward. However, training on the new computers is barely adequate and provision for additional instruction needs to be made. IRS projects that $58 million in additional revenue will be collected from AES in FY 1988 due to increased Revenue Agent productivity. This revenue will not accrue, in our judgement, unless training is increased. Similarly, $10 billion in additional revenue is projected over the 10-year lifetime of AES, which will cost $1.3 billion over the same period. The cost of better training to make this sizeable investment pay off would be modest and well worth the funds expended.

Collection

Total accounts receivable grew from $34.4 billion in December 1984 to $45 billion in December, 1985 -- an increase of 31 percent. Several billion dollars of this growth reflected the backlog of unposted payments and account adjustments built up during the 1985 filing season but, according to IRS, economic factors were also at work. The amounts owed on tax returns increased from $40.8 billion in December, 1984 to $59.6 billion in December, 1985 -- an increase of 46 percent.

Revenue Officer caseloads had already reached unmanageable levels in 1984, and have been a matter of continuing concern on NTEU's part -- a concern expressed to management on numerous occasions. NTEU took action on the budget front when neither the FY 1986 Supplemental nor the FY 1987 budget request contained funds for additional Revenue Officers. Although the additional resources Congress provided in the FY 1987 Continuing Resolution will help, caseloads can be expected to remain excessive for a considerable period.

NTEU remains firmly of the opinion that Revenue Officers should be permitted to exercise sound judgement in entering into settlements that are fair to the taxpayer and fair to the government. We believe that Collection Division's management philosophy is counterproductive because it results in pressure to achieve the maximum number of case closures, leaves Revenue Officers insufficient time to work a case properly, and undermines compliance through unfair settlements with taxpayers.

The Subcommittee should take steps to increase the protection of IRS employees -- particularly Revenue Officers --from assaults, threats and harassment by taxpayers. It should also recommend legislation providing hazardous duty pay for, and treatment of Revenue Officers on

a par with other law enforcement officers for retirement purposes. A Revenue Officer in Buffalo was shot and killed while making a field call; another in Cleveland suffered multiple gunshot wounds at the hands of a taxpayer during a meeting at an IRS office. The duties of a Revenue Officer are more dangerous and stressful than many other law enforcement positions. We believe that law enforcement officer retirement for these employees is fully justified.

Mr. Chairman, that concludes my statement. Are there any questions?

TABLE 1

INTERNAL REVENUE SERVICE FY 88 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 87 CONTINUING RESOLUTION AND SUPPLEMENTAL[1]		FY 88 BUDGET REQUEST		INCREASE OR DECREASE		NTEU RECOMMENDED ADDITION TO RESTORE ABSORPTION IMPOSED BY OMB FOR FY1988[2]		NTEU RECOMMENDED APPROPRIATION FOR FY 1988	
	($000) Amount	Average Positions	($000) Amount	Average Positions	($000) Amount	Average Positions	($000) Amount	Average Positions	($000) Amount	Average Positions
Salaries and Expenses	91,895	1,895	87,165	1,628	-4,730	-267	+6,949	+73	94,114	1,701
Processing Tax Returns	1,470,248	30,629	1,702,576	33,300	+232,328	+2,671	+20,317	+445	1,722,893	33,745
Examination and Appeals	1,668,104	39,699	1,856,581	43,644	+188,477	+3,945	+106,528	+560	1,963,109	44,204
Investigation Collection & Taxpayer Service	1,217,545	28,975	1,425,528	32,089	+207,983	+3,114	+25,135	+312	1,450,663	32,401
TOTAL	4,447,792	101,198	5,071,850	110,661	+624,058	+9,463	+158,929	+1,390	5,230,779	112,051

[1] Includes Supplemental Appropriation of $200 million and 932 positions.

[2] Absorption is the difference between the full cost of the program requested for FY 1988 and the actual amount provided by OMB.

TABLE 2

TAXPAYER SERVICE STAFF YEARS, CALLS TO IRS DURING FILING PERIOD

AND TAXPAYERS ASSISTED, FY 1981-1988

Fiscal Year	Taxpayer Service Staff Years	Calls During Filing Period (Millions)	Calls Answered (Millions)	Total Number of Taxpayers Assisted[1] (Millions)
1981	5,325	34	18	44.8
1982	4,248	34	18	47.4
1983	4,410	34	17	47.1
1984	4,439	31	18	50.1
1985	4,370	56	19.7	50.2
1986	5,696		18.3	46.4
1987	5,395			41.2
1988 (EST)	5,704			42.6

SOURCE: IRS and GAO

1. Includes toll-free telephone, walk-in, and correspondence assistance during entire fiscal year. Does not include tele-tax or outreach programs.

Table 3 Appeals and Tax Litigation

	FY 1985	FY 1986	FY 1987 (est)	FY 1988 (est)
Appeals				
Total Ending Inventory[1]	63,900	117,500	129,600	132,300
Non-Docketed Ending Inventory		50,800	56,600	54,900
Average Caseload per Appeals Officer[1]	63.3	111.7	94.9	83.1
Cases Closed per Appeals Officer[1]	61	58	60	62
Appeals Officers	1,050	1,052	1,365	1,592
Backlog of Tax Shelter Cases	25,683	31,072		
Tax Litigation				
Docketed case receipts	50,800	66,700	61,000	67,000
Docketed case closures	36,100	50,900	57,400	66,300
Docketed ending inventory	82,200	98,000	101,600	102,400
Attorneys	572	570	807	946
Backlog of Tax Shelter Cases	28,500	30,000		

1 Docketed and non-docketed cases

Chairman PICKLE. Thank you very much, Mr. Tobias. I appreciate your testimony.

Let me assure each one of you know that your testimony will be thoroughly read and reviewed by the committee. I would point out to the panel that we have a vote on and I am going to bring this panel's hearing to a close, but I want to make this observation.

Each of you now have commended that we do more at the Internal Revenue Service. Now, you are the practitioners—the American Bar Association, the C.P.A.'s, the C.P.A.'s of New York, and the Treasury Union, and all have recommended, as Mr. Hoffman summarized, that additional amounts should be appropriated for higher salaries, quality training, improved taxpayer services and increased audit coverage, to mention just a few.

Almost every aspect of your testimony related to additional services and the question of what Congress will do about them. But I think it is significant that we observe that you people—who are on the front line or are in the buffer zone between the taxpayer and the IRS in many, many instances, more than any other group—have recommended that we have additional staff, additional training, higher salaries, retain the employees, and put employees on a basis with the professionals.

You are recommending a lot of things that would cost a lot more money. Now, we are going to be in a position of recommending, if we take that position, that we increase expenditures a great deal. And the public is going to say you are budget busters, you are big spendthrifts, get the Government off our back, quit spending this money, particularly for IRS, which is not liked to begin with.

I think we ought to remember and I think your testimony is helpful. We are being told today as a Committee that you, the professionals in the field, said this is very important and ought to be done. So from my standpoint I think it is a good observation that you have come forth on a positive tone and I will pass that on to our colleagues. We will do the best we can.

I also observed that whoever made the statement that you have a question about the calendar year——

Mr. HOFFMAN. I did, Mr. Chairman.

Chairman PICKLE. I appreciate that. We do not know what we can do about that, but that was one of the extra recommendations.

Mr. HOFFMAN. May I just make a remark. We have discussed with many firms that problem and there is no question that there will be more extensions, there is no question that there will be a crisis of attempting to get the workload through in a reasonable period of time. It is going to hit the Service as well, and I wish it would be considered by the Committee.

Chairman PICKLE. Well, I will see that it is passed on and I appreciate you mentioning it.

I am going to have to bring this panel to a close because I only have a short time now to get to the Floor to vote on a rule question. Again, I thank you because your testimony is important.

I want to say to Judge Sterrett that the committee will stand in recess for about 10 minutes. Congressman Rangel will be here to resume the hearings in a short time, so if you would just stay with us we will get to you shortly.

I thank each one of you very much.

[Brief recess.]

Mr. RANGEL [presiding]. We call the first witness of the last panel. Chairman Pickle will be returning after the vote and he asked me to thank the Judge for accommodating the committee and being before us.

The primary focus of the inquiry as it relates to your court, Judge, is the degree of the backlog, what is being done to reduce it, what it's cause is, what the administration and the Congress can do to make resources available to you, and of course, what requests have been made by you to the administration.

As they say, we are from the Government and we are here to help. [Laughter.]

STATEMENT OF HON. SAMUEL B. STERRETT, CHIEF JUDGE, U.S. TAX COURT, ACCOMPANIED BY HON. LAPSLEY HAMBLEN, JUDGE, AND CHARLES CASAZZA, CLERK OF THE COURT

Judge STERRETT. Thank you, Mr. Rangel. I have had the pleasure of testifying before you before and I look forward to doing it a second time.

As you have noticed, my name is Samuel Sterrett and I do appear in my capacity as Chief Judge, United States Tax Court. On my right is Judge Lapsley Hamblen of the Tax Court and on my left is Charles Casazza who is the Clerk of the Court.

Mr. RANGEL. Thank you for coming.

Judge STERRETT. We do indeed very much appreciate the opportunity of appearing before you this morning. As a legislative court, organized under Article I of the Constitution, we of the Tax Court are peculiarly and proudly a creature of Congress.

Congress created our predecessor over 60 years ago as a judicial forum where a citizen could have his tax dispute with the Government resolved prior to having to make any payment. This prepayment right to a judicial determination was correctly viewed as a prerequisite to a public perception that the newly adopted self-assessment system would be fair.

Congress further intended that the to-be Tax Court would serve as a national court that would be the primary forum for the development of tax law at the trial level. We believe that over our history we have fulfilled our purpose by serving as a necessary safety valve in the self-assessment system. Further, the low rate of reversal of our opinions by appellate courts justifies our conclusion that we are indeed the main repository of judicial tax law.

Perhaps the ultimate proof of our utility to the administration of taxes, though surely not an unmixed blessing, is our large inventory of docketed cases, numbering some 80,606 as of March 31, 1987 and with over $20 billion in dispute.

Naturally, numbers of this magnitude are a matter of concern and demand constant analysis and observation. Fortunately, our analysis has demonstrated that matters are not as critical as may first appear. Some 80 percent of our inventory has been docketed within the last two years.

Some 45,000 of the 80,000 pending cases involve tax shelters. This means that there are considerably less than 45,000 issues in

those cases and that those cases should be disposed of with a relatively few trials.

Within the past year or so the Court has handed down dozens of tax shelter opinions which should lead to the wholesale disposition of blocks of cases.

At this point, Mr. Rangel, it might be helpful, sir, if I set forth a profile of our existing inventory: Responsibility of a named judge—by that I mean a designated particular individual—42,600 cases have been assigned to such a judge; the small tax cases, aggregate 9,800; filed within the last six months, a total of another 13,400. So we have left available for docketing in the Fall of 1987 14,800.

If my arithmetic is correct and the calculator is, that again adds up to 80,600.

You might fairly ask, what does the Court intend to do about this large inventory? Within the past year or so we have made substantial changes in our management technique. First, we have put increasing emphasis on assigning as many cases as possible to a particular judge with a stated responsibility to move his or her cases through the judicial process as efficiently and quickly as possible; note the 42,600 figure just given.

Two, cases are scheduled for trial on a First-in, First-out basis, which prevents cases from slipping through the cracks without being noticed for trial. Cases are continued only for good cause.

Three, the number of cases noticed for trial has been doubled, bringing twice the number of cases to the forefront for consideration.

Four, some of the more prevalent tax shelter activities are being assigned to a particular judge who, becoming familiar with the activity, can manage such cases more efficiently.

Five, judges are being assigned to back-to-back sessions in major cites, which increases the judge's ability to supervise the cases scheduled for trial.

Six, an expanded Standing Pre-trial Order permits the judges to become aware of a need for his or her involvement in a case at an earlier stage than heretofore.

Seven, each judge is keeping detailed records of the status of the matters pending before him or her, thus aiding the judge to keep the work current.

Our management philosophy, sir, is to try to be innovative, utilize new techniques, but not to be reluctant to cast aside any that do not work. Our goal is to set the great majority of our cases for trial within one year from the date the petition is filed, and, even including the time allowed the parties within which to file post-trial briefs, to hand down an opinion within one year from the date of trial.

You have asked whether we have sufficient resources to do our job. My response is that our requested budget of $28,120,000 will be adequate. The only adjustment I might make with respect to our testimony to the Appropriations Subcommittee is that our personnel limit be raised from 339 to 350, an increase which we would absorb within our dollar budget request. The increase would be used primarily at the clerical level to help us with the enormous volume of paper work.

In terms of our judicial offices we believe that we are fully staffed. Any increase would make it more difficult to ensure that each member of the Court is part of a unified approach to questions of tax law, the approach that Congress has expected us to have.

Mr. Rangel, it is a pleasure to be here sir and I will be happy to answer any questions when you deem it appropriate.

[The statement of Judge Sterrett follows:]

STATEMENT

OF

SAMUEL B. STERRETT

CHIEF JUDGE, U.S. TAX COURT

This statement provides background for Chief Judge Sterrett's oral testimony before the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, concerning the inventory of cases before the U.S. Tax Court. By letter dated April 17, 1987, Chief Judge Sterrett submitted to the Honorable J.J. Pickle an interim report on the Tax Court caseload and measures being taken to close cases more efficiently.

INTRODUCTION

By way of summary, this statement includes a discussion of the status, jurisdiction, and structure of the U.S. Tax Court.

The United States Tax Court is a court of record established under Article I of the Constitution of the United States. 26 U.S.C. § 7441. The Tax Court thus has the unique status of a judicial body in the legislative branch of the government. The Tax Court is the only forum where tax deficiencies determined by the Commissioner of Internal Revenue can be litigated without first being paid. (The United States District Courts and the United States Claims Court have jurisdiction where the taxpayer first pays the tax and then sues for a refund.) Approximately ninety percent of all federal tax litigation in this country is conducted before the U.S. Tax Court.

As an independent, national, adjudicatory tribunal, the Tax Court provides a uniform interpretation of the Internal Revenue Code -- Title 26 of the United States Code. The Tax Court has jurisdiction over controversies involving deficiencies in income, estate, and gift taxes. The Court also has jurisdiction to redetermine deficiencies in certain excise taxes (principally those imposed on private foundations and foundation managers) and in windfall profit tax; to redetermine liabilities in respect of certain transferees and fiduciaries; to issue declaratory judgments in the areas of qualification of retirement plans (including pension and profit-sharing, stock bonus, annuity, and bond purchase plans), exemption of charitable organizations and the status of certain governmental obligations; and to decide certain cases involving disclosure of information contained in written determinations issued by the Commissioner of Internal Revenue.

All decisions of the Court, other than those in small tax cases, are reviewable by the United States Court of Appeals with venue and, thereafter, by the Supreme Court of the United States, upon the granting of a writ of certiorari.

The Tax Court is a trial court, headquartered in Washington, D.C., whose judges and special trial judges sit throughout the United States. The Tax Court is comprised of 19 judges appointed by the president, by and with the advice and consent of the Senate. Each judge serves for a term of 15 years. Judges of the Tax Court who retire from regular service are designated "senior judges" and may be recalled by the Chief Judge to perform judicial duties. At present, six senior judges are working on tax cases; they represent a valuable resource of knowledge and experience to the Court. In addition to its presidentially appointed members, the Tax Court is authorized 17 special trial judges who are appointed by the Chief Judge and serve at the pleasure of the Court. The special trial judges hear small tax cases (those involving $10,000 or less), certain regular tax cases, and motions and pretrial matters.

The Tax Court is a "circuit-riding" tribunal. With the exception of the Chief Judge, all judges and special trial judges are presently traveling approximately 15 weeks each year, hearing cases in different locations throughout the country. The judges hold sessions in over 80 cities, including Washington, D.C. The petitioners are allowed to select the place of trial from a list

maintained by the Court. This extensive travel schedule is required to satisfy the Internal Revenue Code's mandate that the Court prescribe its sessions "with a view to securing reasonable opportunity to taxpayers to appear before the Tax Court or any of its divisions, with as little inconvenience and expense to taxpayers as is practicable." 26 U.S.C. § 7446.

TAX COURT INVENTORY AND CASE MANAGEMENT

As of March 31, 1987, the Tax Court had pending before it 80,606 cases. Although this is a considerable inventory, it must be viewed in relation to new filings and the Court's progress in disposing of dockets. For example, nearly 80 percent of the cases currently before the Court were filed within the last two years. The last fiscal year (1986) produced record levels of new cases opened by taxpayers and case closings by the Court. On October 1, 1986, the Court had a beginning inventory of 72,836 cases. During the next twelve months, 48,398 new petitions were filed. Although the Court succeeded in closing nearly 38,000 cases in fiscal year 1986 by way of Court opinions, dismissals, and settlements, the pending caseload at year end was 83,686 -- representing over $16 billion in deficiencies.

The statistics for 1986 indicate a continuation of the annual increases in filings and closings within the last decade. Since the end of fiscal year 1977, the number of cases filed has increased 292% -- from 12,339 petitions in 1977 to over 48,000 petitions in 1986. The number of cases closed increased 266% between 1977 and 1986. In 1977, 10,374 cases were closed by the Court; in fiscal year 1986, there were 37,937 dockets closed. The result was an increase of 293% in the number of pending cases over the last nine years.

The statistics for the last six months, however, evidence some progress in reducing the Court's inventory. The Court is pleased to state that a record 4,400 cases were closed in March 1987. The 1986 closing inventory has been reduced by over 3,000 cases. Still the number of pending petitions exceeds 80,000 and the busiest filing season will be beginning soon. Consequently, there is much work ahead for the judicial officers and staff of the Court. Although the number of cases filed in the Tax Court has increased 292% since 1977, the personnel levels have increased only 64% in the last nine years. Even with the assistance of automation, our staff has taken on large responsibilities.

In response to the constantly increasing caseload, the Court has, in recent years, implemented a variety of new case management techniques. We realize that substantial reductions in our inventory depend upon effective, long-term methods for handling our workload. We have focused on the method for setting cases for trial, the judges' control of cases once they appear on the trial schedule, and the issuance of opinions in cases in which the trial has been completed.

Generally, more and more cases are being given to a particular judge soon after docketing, rather than remaining unassigned for a long period, as in the past. Tax shelters, as they are identified, are being assigned to individual judges, who then become responsible for those groups. Certain judges receive particular types of shelter groups, thus enabling them to become familiar with the activity. Approximately fifty percent of the identified shelters are now assigned.

Among the other steps the Court has taken is to increase the number of cases being scheduled for trial. The Court is placing approximately 100 cases on each one-week session conducted by a judge, and 200 cases on a two-week session. This is a significant increase over the number of cases noticed for

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trial on sessions in past years. Furthermore, as of January, the Court has been scheduling cases for trial under the first in, first out ("FIFO") method to assure that cases are heard timely and in the appropriate order. Additionally, we are sending judges to a particular city two or three consecutive times to conduct "back-to-back" sessions; the judges thereby retain stricter control over the cases being heard.

In a further effort to maintain control over particular dockets, the Court is requiring judges to retain jurisdiction over a case which is reported at the trial session as having been settled, but for which the necessary paperwork has not as yet been prepared. In many of these instances, the judges are requiring the parties to state orally for the record of the case the terms of settlement. The judges then "follow up" to insure that the parties promptly submit proposed decision documents.

Finally, administrative improvements have also increased the efficiency of Court operations. In May 1986, the Court implemented an automated docketing system which has provided great assistance in processing papers through the Clerk's Office. The judges and their staffs are utilizing word processors in drafting opinions and orders. Also, some of our judges have begun using personal computers for case management and we expect to see this increase. During the remainder of fiscal year 1987 and in 1988, the Court anticipates further advancements in these areas, including introduction of automated statistical reporting.

We have summarized some of the major management techniques now used by the Court. In addition, individual judges have developed methods for expediting the resolution of cases to which they are assigned. For example, a number of judges issue a Standing Pretrial Order to the parties, requiring them to, inter alia, meet prior to the session to conduct settlement negotiations, submit a status report before the session, and file a trial memorandum setting forth the issues in the case, a summary of the witnesses' testimony, and the legal arguments to be advanced.

In addition to all these measures, the Court continues to review its procedures and develop strategies for making the system as effective as possible. Our objective is to reduce the Tax Court inventory while still assuring a high level of competence and expertise in our work.

SMALL TAX CASE PROCEDURES

The Court's small tax case procedures which apply, at the election of the taxpayer, to those disputes involving $10,000 or less for any one taxable year, have been extremely successful. Small tax cases, or "S" cases, are handled in a unique fashion. A major consequence of electing to have a matter treated as a small tax case is that the decision of the Tax Court is final; neither party may appeal to any other court. The proceedings in "S" cases are much less formal than in regular cases. Rules of evidence are relaxed and the Court often assists the petitioner in bringing out evidence relevant to the case. Almost ninety percent of the small tax cases are litigated on a pro se basis. In the small tax case process, the Court attempts to accommodate taxpayers with simple, fair procedures and prompt resolutions of their disputes. On average, opinions in small tax cases that are tried are filed within 5 months of the date of trial. By comparison, opinions in regular cases that go to trial are filed, on average, within 14 months of the trial date.

SPECIAL TRIAL JUDGES

As noted above, the judicial officers of the Court include its presidentially appointed members (including senior judges) and the special trial judges. While the special trial judges hear primarily small tax cases, they may also be assigned to regular cases under $10,000, and they consider and rule on motions and other pretrial matters. The Court has also begun to assign many tax shelter cases to the special trial judges. Additionally, the Tax Court has permanently assigned one of its special trial judges to Los Angeles which is the location selected for trial by approximately twenty-five percent of the petitioners before the Court. We continue to consider the most effective ways to utilize the special trial judges in managing our overall inventory.

CONCLUSION

The Tax Court takes seriously its responsibility for the more than 80,000 cases on its dockets. In recent years, we have devoted time and effort to developing and implementing strategies for placing more cases on the trial schedule and disposing of cases once they have been tried. Our pending inventory increases annually; however, the Court has been closing tens of thousands of dockets each year. The filings continue to increase, and we may see further litigation as the new tax laws affect taxpayer transactions. Nevertheless, we believe that the management tools now being used will have a beneficial effect on the size of our caseload. We see progress already and we expect to see further improvement.

Mr. RANGEL. Thank you, Judge.

The Chairman wants to make it absolutely clear that the Committee is not here to be critical but to get your views as to what, if anything, we can do and your testimony almost charges us to do nothing.

Does this mean that you are satisfied with the rate in which the cases, the backlog, is being reduced?

Judge STERRETT. No, sir, it does not mean that at all. We are not satisfied. We think that we have room for improvement, but we put these measures into effect rather recently and we do not think we have seen the full force of them. But by no stretch of the imagination do I mean to convey the impression that we do not think we have problems, because indeed we do.

We believe the problems are manageable and we would look forward to coming back next year and reporting to you how effective, or ineffective, these new measure may have been.

Mr. RANGEL. Could you share with us what your estimates are as to the new cases that would be added on to the calendar as well as the percentage in which you hope to reduce the backlog next time you come back? We had figures that the caseload is estimated to go over 100,000 cases by fiscal year 1988, or a 20 percent increase.

That is like dipping water out of the ocean. Is that a fair estimate as to the rate of increase in cases and are you satisfied that your reduction and the increased cases will not cause the backlog to remain as it is or to increase?

I know there will be different case with First-in, First-out, but——

Judge STERRETT. Mr. Chairman, I recognize that before the Appropriations Committee we estimated that our inventory would be 92,000 or 93,000 at the end of 1987 and 100,000 by the end of 1988. I am sure you would appreciate that when you are testifying before the Appropriations Committee one tends to be conservative because matters may get worse, but I am optimistic, although the Clerk, I must say, does not agree with me.

It is my prayerful hope that we will not hit 90,000 this fiscal year. We closed in March over 4,400 cases, which was a record. I expect us to close over 40,000 this year and I do not believe that we will see that 100,000 figure, unless, of course, the IRS sends out far more Notices of Deficiency than they currently plan to do, as I understand their plans.

We have no control, of course, over the cases coming into the Court because if a taxpayer gets a Statutory Notice of Deficiency, he has a constitutional right, so to speak, to file a petition in our Court and we must receive it.

So we cannot control the inflow. But it is my understanding of their approach to matters that there will not be a large number of increased statutory notices and we remain optimistic that with our new techniques that we will not hit those figures, but honestly I cannot guarantee that we will not.

Mr. RANGEL. No. We are not talking about guarantees. As a matter of fact, we are talking about guesstimates. But assuming that with all of the resources and technology and the managerial systems that you locked into place that you are able to achieve your goal of reducing the caseload by 40,000, you are guessing—as

we are—that there will be X number of cases added to the calendar.

Are you saying that you hope that this has leveled off at 90,000?

Judge STERRETT. I certainly am saying that is what we hope and I think it is a reasonable possibility. We know that we are narrowing the gap between the case filings and the dispositions. There was about a 10,000 case gap in fiscal year 1986.

I am confident that there will not be a 10,000 loss, so to speak, in fiscal year 1987. I hope to hold that loss to a matter of three or four thousand, and in fiscal year 1988, barring unforeseen circumstances, I believe that we will have a balanced budget, so to speak.

I do not think I am pulling figures out of the air, hoops out of the air, Mr. Rangel. I think it is a reasonable possibility.

Mr. RANGEL. When you say balance, what do you mean?

Judge STERRETT. A balance between the cases filed and the cases disposed of. The problem in the last few years has been that the filings of petitions has gone up and we have not closed as many cases in a particular year as have been filed, so therefore the inventory keeps getting added on to.

What we are doing now is narrowing that gap between the number of filings and the number of closings. As I suggested, I believe and hope that we can narrow that gap to three or four thousand in fiscal year 1987 and eliminate that gap in fiscal year 1988 and then hopefully the grand total of inventory will recede.

Part of the reason I believe this is the tax shelter case area. I have just seen Mr. Nelson's testimony and I know that he is going to testify that there are some 290 shelter projects involving 30,000 cases. Now, the 30,000 sounds terrible, but if there are 290 shelters involved in that, you are not going to have 30,000 trials, you are going to have maybe just 290 trials and dispose of 30,000 cases.

It is that sort of technique of working, insisting that the lawyers are prompt, insisting that the prevailing side, so to speak, files a Motion for Summary Judgment so that subsequent cases are covered by the lead case. We are trying to dispose of blocks of cases by picking a test case and saying this guides all of the cases.

Mr. RANGEL. What you are saying is that your budget request takes into consideration everything that you think that you would need in order to meet the goals that you have set out for yourself in reducing the gap and reducing the backlog and that you do not need any more judges or judicial staffs or law clerks in order to get the job done?

Judge STERRETT. Well, we may need some more law clerks, sir. That is why I have asked for more personnel, from 339 to 350.

Mr. RANGEL. Would that include clerical employees as well?

Judge STERRETT. Yes, it certainly would. I do have in mind hiring three or four sort of senior law clerk types to help us, but in terms of a total figure of $28,120,000, sir, if we do not do the job, it will not be your fault.

Mr. RANGEL. And you do not have problems with courtroom space at all, right?

Judge STERRETT. Yes, we do, indeed. In some of the cities throughout the country we do have problems getting courtroom space and that is one of the reasons—perhaps not one of the most important reasons—but that is one of the reasons we could not

handle any more judges. We do in some cities have terrible time getting courtroom space.

Mr. RANGEL. Did you request funds for courtroom space?

Judge STERRETT. Yes, sir. That is in the $28 million. Yes, sir. It is getting the physical space available more than the money. It is just not there.

Mr. RANGEL. Mr. Chairman, the Judge has eloquently pointed out that the situation is well in hand, that the cases are going to be dramatically reduced by summary judgment and that he has got a $28 million request in. They do not need any more judges. They need some clerical support. They need some courtroom space and he has got money in there for that. He is cautiously optimistic.

Judge STERRETT. That is a fair summary, sir.

Chairman PICKLE. Well, Mr. Rangel, I have looked at the volume of cases before the Court and they are enormous.

Judge STERRETT. Yes, sir.

Chairman PICKLE. You take a big whack at them one year but they come back even in bigger numbers, so it looks to me like you are fighting a losing race instead of getting the thing under control. I cannot believe you say everything is in order and you are not disturbed about the volume.

Did I misunderstand Chairman Rangel?

Judge STERRETT. Well, no. Mr. Rangel simply did not quote everything I had said. I did not say that we were not disturbed by the numbers because, of course, we are disturbed by the numbers.

Anytime you have figures of 80,606 that gets your attention. We are indeed disturbed about those numbers and we have all sorts of calculations and charts and comparisons where we trace back how we were doing in prior years so that we can make the best possible estimate about the future.

But the point I did make to Mr. Rangel is that, for example, in the first six months of this fiscal year we have closed a record number of cases. What I was suggesting is that our techniques of disposition have improved to the extent that we expect to close greatly the gap between the number of cases filed in fiscal year 1987 and closed.

But we have a problem, sir. I am not coming up here and saying that everything is hunky-dory. We have got to be ever vigilant.

Chairman PICKLE. Well, what disturbs me is when I look at the statement that for fiscal year 1986, the number of cases filed and closed and cases pending at the end of the year were the highest in the history of the Tax Court.

Judge STERRETT. Yes, sir.

Chairman PICKLE. Now, that means that you have increased almost 500 percent since 1970, or even 150 percent within the last year or two.

Judge STERRETT. Yes, sir.

Chairman PICKLE. Now, it looks to me like that trend is increasing, and if that is increasing I do not take comfort in taking the attitude of complacency that everything is in order and we are handling them as we should.

This disturbs me that the trend seems to get higher and higher and higher.

Judge STERRETT. Well, let me say again, sir, by no stretch of the imagination are we complacent. It is these management techniques that I have set forth in my statement that I would hope would indicate to you that we are not complacent and that we have taken a difficult situation and tried to make some adjustments which eliminate what has been a growing gap. But I cannot repeat too often that by no stretch of the imagination are we complacent.

We have a problem, Mr. Chairman. What I am trying to say is we think that the measures we have recently adopted, when they become fully effective, will get us back on an even track.

Chairman PICKLE. Well, Judge, it would appear at first to us that you were not asking for any additional personnel. You said no, that was not accurate, that you have asked for additional personnel. But as I understand it from looking at the figures, what you are asking for is a total increase from 339 to 350 of attorneys and law clerks. That is just 11, now, for your Court, the whole system, as well as two or three other full-time attorneys in some capacity.

So you are only asking for 11 and maximum 14 additional people and you have got a backlog of 90,000 cases. Now, that is not much of an increase for personnel. I am not trying to say you ought to come up here and ask for a lot more money or more personnel, but it does disturb me when you say, oh, yes, we really need some new personnel, and you are asking for 11 out of 350. To me that is not much of a bold statement that we need help?

Judge STERRETT. Well, no, sir. I do not know that I would characterize it as a bold statement. Hopefully it is an honest statement.

Chairman PICKLE. It is an honest statement? You think that is all you need?

Judge STERRETT. Yes, sir. That is our best judgment at this time.

Chairman PICKLE. Well, all right. You see, I am not an attorney and I am not in a position to say that you are not accurate, but it sounds to me like that is a measly request. I would think that the people out over the country when you said yes, and you were talking about 90,000 backlog and you say we need 11 new law clerks, they would want to bore me for a hollow-horn and send me back to the sticks.

Judge STERRETT. It is 80,000 sir, not 90,000.

Chairman PICKLE. It does not sound very much like an encouragement to me.

Judge STERRETT. I confess, sir, that it has a measly sound to it, but all I can say is that is our best judgment at this time, and if it turns out that our judgment is not correct, we know that you are going to call us back up here.

Chairman PICKLE. Well, if it is in error I think we might do something this time.

Let me ask you—we just do not accept that it is in error. We may do a little whip popping ourselves up here because we cannot tolerate these big increases.

Now, I notice your Tax Court holds three terms. You have got a fall, winter and a spring session. Why do you not hold a summer session?

Judge STERRETT. We are seriously considering that. That is a valid point.

Chairman PICKLE. Now, that is encouraging. Well, now when regular cases go to trial, it seems to me like that is an average of what? You said it takes about 14 months to settle a case? Is that what you are saying?

Judge STERRETT. The average time of disposition from trial date to opinion date is 14 months.

Chairman PICKLE. All right. Well, now, is this 14 month time lag increasing each year? It is bound to have been less years ago and it has gone up to 14. It is increasing, is it not?

Judge STERRETT. Do we have any recent figures on that, Mr. Casazza?

Mr. CASAZZA. It may have increased some. Mr. Chairman, were you referring to the time period from when a case first was filed until it got scheduled for trial?

Chairman PICKLE. Yes. From the time it is filed to the time it is adjudicated. That is what I have in mind.

Mr. CASAZZA. The whole way?

Chairman PICKLE. Yes. Fourteen months?

Judge STERRETT. No.

Mr. CASAZZA. You have to divide that into two parts, Mr. Chairman.

Chairman PICKLE. Well, divide it then.

Mr. CASAZZA. The first is how long is the time from when the case is first begun until we reach it for trial, the taxpayer has the opportunity to go to trial. And in that instance, as Judge Sterrett said, in 85 percent of the cities at which we conduct trial sessions we are reaching those cases for trial in approximately 12 months. So that would be the conduct of the trial itself.

Chairman PICKLE. Well, whatever the time, it is a long period of time, and somehow that seems to be getting longer instead of getting shorter, and that is a bad trend.

Judge STERRETT. Mr. Chairman, I would agree with you sir. As I said earlier, and I believe also in my statement, we do need to improve. We do need to get those cases to trial sooner and we do need to get our answer, our opinion out sooner.

We have set a goal. We have internal controls now where we are going to get the vast majority of cases to trial within a year and get an answer a year from trial. And bear in mind, please sir, that the parties file briefs after the trial. So if it takes a year from the date of trial to the opinion, a large part of that time has been taken up waiting for the parties to file briefs.

But I do believe if we get a taxpayer an answer within two years from the time he files his petition, that would compare very favorably, sir, with any court in the country. But we have work to do.

Chairman PICKLE. Let me ask you a question that the staff has asked me to propose to you, and that is, can you make better use of the special trial judges, for example, by assigning them to interlocutory matters? Would that speed up your process?

Judge STERRETT. That will and does speed up the process. Yes, sir. That is a thought that we endorse and we are using the special trial judges in that capacity. We are trying to make it more convenient to the taxpayers to have these interlocutory motions heard out in the field. There is no doubt that we are still finding more effective ways to use the special trial judges.

It is a relatively new concept and we have not got all of the wrinkles ironed out of their use, but there are a lot of complicating factors that one has to take into account. The whole tax shelter area is a relatively new invention of the innovative tax lawyers out there, and in all candor it took us a little while to figure out how to get a handle on taking care of these cases which in reality are a class action type cause of action.

Chairman PICKLE. I note you were making a comment to Mr. Rangel about how you would improve the case management of the Tax Court judges, and I am sure you have given him a specific recommendation. I want to just make this observation to you.

I did not realize that we were having this big backlog in the Tax Court and that it is getting bigger and bigger. It may well be that you are handling them as quickly as possible, but though you do handle thousands of them on an annual basis, there are thousands of more keep coming in, and there is more water coming in the bottle than going out, so sooner or later it is going to overflow and we bog down.

It has come to my attention that this is a very serious matter. The lawyers in my State are complaining about the long time it takes to get one of these settlements. I guess I will just make a general observation to you that as one member of this Committee, I am going to watch now what happens in this Tax Court this coming year and we are going to see what kind of volume you get and what percentages go up or down and how effective you are. I am going to give it a little personal attention to see how it comes out.

It may well be that we have no grounds to be alarmed or to be critical, but I think it is time for us to take a good hard look at that and that is what I think this Subcommittee will do as we go forward.

Judge STERRETT. We are not fearful of you taking a hard look at all, sir. We would be happy to have you do it.

Chairman PICKLE. That would be fine. Mr. Rangel, I believe that is all of my questions.

Mr. RANGEL. Mr. Chairman, you were questioning the Judge about the 14 month delay and staff brought to my attention page 3 of the Judge's testimony, which focuses on the small tax cases procedures. If I understand this correctly, Mr. Chairman, the Judge is saying that after the trial, in the small cases, it takes approximately 14 months before an opinion is written by the judge.

Judge STERRETT. No, sir. Not in the small tax case area. In the small tax case area, in the cities that we go to with any degree of regularity they come to trial——

Mr. RANGEL. Strike that out. The regular cases you have, by comparison, opinions in regular cases that go to trial are filed on the average within 14 months of the trial date. Now, could you tell me Judge, why after the matter is adjudicated it would take 14 months to get an opinion written?

Judge STERRETT. Well, bear in mind sir that the trial is the place where the parties introduce the evidence and make a record, so to speak, of what they view to be the relevant facts. Only following that do they file briefs. Each side will file a brief making proposed findings of fact based upon the evidence introduced at trial, and

then each side will argue the law from their proposed findings of fact, and then, obviously, each side says therefore I win.

So in short the case may not be ready for consideration by the judge for anywhere from three to six months after the trial. But I am not saying that 14 months is not too long. We are working on that, sir. I am not saying that is a satisfactory figure.

Mr. RANGEL. I guess what I do not understand is that I know that you are saying that you can dispose of large numbers of cases because so many of them are alike and by getting rid of one small group a larger group will be disposed of, but if it takes this long to get the opinions, I just do not know why you would not be requesting more court space and more judges in order to take care of this backlog.

In New York in non-federal matters and non-tax matters we bring up civil court judges to sit in the Supreme Court to relieve the temporary backlog of the calendar and the judges just welcome the opportunity even to participate on that level. With the prestige that is enjoyed by the Tax Court it would just seem to me to alleviate this balloon which is there that you might ask for this type of temporary relief until you can get your head above water.

Judge STERRETT. Well, I am frank to say, sir, we had not thought of asking for any temporary help. Congressman, when Congress created us in 1924 it created us as a Court that would be based in Washington with a manageable group which would consider cases and make sure that the cases involving taxpayers in California were the same as the answer a taxpayer would get in Florida, for example, rather than if you go to a district court, you could get different answers in different parts of the country.

So if that remained to be Congress' goal for us—and you set the goal, sir—if that remains your goal, at some point we can get so large that we lose the ability to manage. But in all candor, I have not considered the temporary help and I will take that thought back and we shall consider it.

Mr. RANGEL. Well, you threaten us with our constitutional goal, but if we never reach it, Judge, what difference does it make?

Judge STERRETT. Also, as Mr. Nelson I believe will tell you, there is also a problem of Government attorneys and how many cases can they try.

Mr. RANGEL. Well, wherever you find the problem, Judge, we are asking you to point us in the right direction to bring some relief, because when it comes to Government attorneys we have a lot of people that want the experience, not to make a career out of Government, but to come in and to play an important role and then perhaps to go back out into the private sector.

But it is indeed an honor and privilege to participate in the Tax Court no matter what level you are doing it, and we just hate to constantly get caught in the position that we are appropriating money and throwing it at the agency and they use it for the common good but find themselves restricted by the policy considerations of the Office of Management and Budget, and sometimes we get less than candid responses to our questions, the judiciary being an exception to that general rule.

Judge STERRETT. It may be that we should or could hire some temporaries. We would have the authority to hire special trial

judges. The so-called regular judges are appointed by the President, and so we do not have anything we can do about that. But we do have the authority to hire some special trial judges and perhaps we ought to consider that.

In terms of Presidentially appointed judges, I might point out that we do have a vacancy now, and that is nothing we have any control over and we are going to have another vacancy this summer. As a matter of fact, part of the problem is, in all fairness to ourselves, that if we had all our full complement we would be able to handle more cases.

Normally the Chief Judge does not go out and hear sessions, but by reason of the fact that we are short, I personally am going up to Newark in June because we do not have somebody else to send up there, so I am going to be in Newark for a couple of weeks.

Mr. RANGEL. Well, the Chairman has got to do whatever he can to be of assistance in this area so that you get a full complement, but what happens with our form of Government is sometimes the judiciary does not understand the full political implications when you have your problems there, and we, of course, are constantly going home to our constituents, and what we see happening is an erosion of the confidence in the tax system, and it is not just the fancy lawyers that are complaining that they cannot get cases adjudicated.

All you need is one disgruntled taxpayer explaining why it takes 14 months in order to decide that he is right or wrong as the case may be, and you find a lot of people who do not believe that the system is going to work or work fairly on their behalf, and that is the speedy trial and everything else.

We hear it on our end, Judge, and what we are trying to do is what I know you want done, and that is to make certain that you can have some balance between the cases disposed of and the cases you receive, and even though I will not be able to do too much with this Administration, a person of the stature and the statesmanship of Jake Pickle certainly can pick up the phone and get the support that is needed.

Chairman PICKLE. Judge, we do appreciate your appearance here and we are concerned about it. We do receive quarterly reports and toward the fall we will see what progress has been made and how we are actually handling things. We are getting a lot of complaints from attorneys all over the country and we are naturally concerned about it, as I know you are. We will be visiting with you regularly as we go along on this.

Do you have any additional statement or any of your witnesses with you?

Judge STERRETT. You have our attention, sir.

Chairman PICKLE. Well, and I think the attention of the country about these big backlogs, so we hope we can all do better on it. I appreciate your attendance and your testimony. Thank you very much.

Judge STERRETT. Thank you, sir. It was a pleasure to be here.

[The following was subsequently received:]

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COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

SUBCOMMITTEE ON OVERSIGHT
April 29, 1987

The Honorable Samuel B. Sterrett
Chief Judge
United States Tax Court
400 Second Street, N.W.
Washington, D.C. 20217

Dear Judge Sterrett:

In order to complete the record on the segment of the Subcommittee on Oversight's April 23, 1987 hearing on the ability of the Internal Revenue Service and the Tax Court to reduce the backlog of pending Tax Court cases, please respond to the following questions.

1. What further changes, if any, are you planning to take to improve the calendaring procedures of the Tax Court?

2. The Tax Court continues to issue bench opinions -- a tool Congress authorized in 1982. Do you forsee a greater use of this type of opinion? Are other procedural "tools" needed from the Congress?

3. As you indicated in your prepared testimony, a unifrom Standing Pretrial Order, now used by a number of the Tax Court judges, requires the parties in a case to meet prior to the session to conduct settlement negotiations, submit a status report before the session and file a trial memorandum. If this Order has proven to be extremely useful, why not make it mandatory for all the judges?

4. The Tax Reform Act of 1986 provides that failure by a taxpayer to exhaust administrative remedies is an additional basis that the Tax Court may consider in imposing the IRC §6673 penalty for dilatory or frivolous proceeding in the Tax Court.

   a. Will this new basis (failure to exhaust administrative remedies) have a major impact in reducing the Tax Court backlog? If not, why not?

b. Should exhaustion of administrative remedies be made a prerequisite to obtaining Tax Court jurisdiction?

5. Beginning with 108 locations, the Tax Court began phasing out certain cities in which only small tax cases were heard. There are now approximately 80 cities in which taxpayers may try their cases. Has this reduction in any way affected the case load of the Tax Court?

6. How has the recently automated docketing system helped the Tax Court in processing documents?

7. Should the Clerk's office hire temporary personnel to handle the increase in case filings that occurs each year beginning in April?

8. Is the IRS being timely notified of petition filings so as to prevent "premature" assessments?

I appreciate your prompt attention to this request. Please provide a response by May 22, 1987.

If you have any questions concerning this letter, please contact the Subcommittee staff at 225-5522.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tml

For the record

UNITED STATES TAX COURT
WASHINGTON, DC 20217

CHAMBERS OF
SAMUEL B. STERRETT
CHIEF JUDGE

RECEIVED
MAY 19 1987
Ways and Means
Subcommittee on Oversight

May 19, 1987

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Pickle:

In response to your letter of April 29, 1987, I am providing the following as a supplement to the record of the Subcommittee on Oversight's April 23, 1987 hearing on the Tax Court's caseload.

1. Improvements in the Calendaring Procedures of the Tax Court

As noted in our report to you dated April 17, 1987, the Tax Court, in January 1987, began using the first-in, first-out (FIFO) method for scheduling cases for trial. This system assures that cases are being noticed for trial in the appropriate order, and that no cases are overlooked or are allowed to remain on our dockets without action being taken on them. We expect the system to be effective, and we anticipate continuing its use on a long-term basis.

Additionally, the Court is scheduling a greater number of cases on each session than was scheduled in past years. Generally, 100 cases are scheduled for each one-week session conducted by a judge or special trial judge, and approximately 200 cases are scheduled on a two-week session. Accordingly, more cases are coming to trial at an earlier stage and, further, with more cases being noticed for trial, the number of settlements will increase as well.

The Court has also been increasing the number of "special sessions" which it holds. These are sessions scheduled in addition to the regular weeks of trial the Court sets during the course of the year. Special sessions allow for the prompt trial of cases involving extended trial time, and is a further indication of the Tax Court's willingness to be flexible and accommodating to the parties in order to hear cases in a timely fashion.

Finally, we are sending judges to a particular city two or three consecutive times to conduct "back-to-back" sessions; the judges thereby retain stricter control over the cases being heard.

The Court will continue to study its procedures and develop strategies for making the system as effective as possible. New initiatives will be implemented as we determine what further changes are appropriate. For example, serious consideration is being given to holding 4 or 5 calendars in the 1988 winter term, as distinguished from the current practice of 3, in the high volume cities.

2. Bench Opinions and Other Procedural "Tools"

As noted in our report of April 17, 1987, the Court issues approximately 300 to 350 bench opinions each year. Bench opinions are an effective and useful tool in simple cases or cases involving a single legal issue. However, some cases are too legally complex or factually intricate to be disposed of by bench opinion. The Court continues to encourage its judges to use bench opinions in appropriate cases, that is, those in which the facts and applicable law are clear.

The Court does not have any specific suggestions for other procedural "tools" which Congress might authorize it to use; however, we will continue reviewing this issue internally and will make recommendations to Congress if we believe specific procedural mechanisms should be authorized.

3. Standing Pretrial Orders

A majority of Tax Court judges are using a Standing Pretrial Order which directs that decisions in settled cases be submitted prior to the calendar call and warns that continuances to permit filing of settlement documents will be granted only where it is clear that settlement has been approved by both parties. While some judges have found the Standing Pretrial Order to be an extremely effective tool, the Court, as a whole, is continuing to evaluate both the benefits and burdens of the process. Among the drawbacks of mandating use of a Standing Pretrial Order are the increased paperwork imposed on counsel for the parties, the difficulty in attempting to have pro se taxpayers comply with the order, as well as the additional paperwork which the judge is required to review in preparing for the cases on a session. Thus, although use of the order has reduced the number of cases in which documentation of a settlement is delayed, there are drawbacks to requiring that an order be used.

In sum, the Court is encouraging its judges to use Standing Pretrial Orders in appropriate cases; however, their use has not yet been required and we think that it may be premature to mandate their use based on our experience to date.

4. Taxpayer's Failure to Exhaust Administrative Remedies

a. Impact of Amendment to Section 6673 on Tax Court Caseload

As we stated in our report of April 17, 1987, the Court has not yet imposed damages under section 6673 for a taxpayer's unreasonable failure to pursue administrative remedies. This amendment to section 6673 is effective for proceedings commenced after October 22, 1986. Consequently, it may be another year or more before the Court actually has occasion to consider the imposition of section 6673 damages on this new basis. Accordingly, it is impossible for us to evaluate whether this amendment will have a major impact on the Tax Court's caseload. Hopefully, more information will be available within the next year at which time we may be able to better estimate the effectiveness of the amendment to section 6673.

b. Exhaustion of Administrative Remedies as a Prerequisite to Obtaining Tax Court Jurisdiction

The Court supports, in principle, the concept of requiring taxpayers to exhaust their administrative remedies prior to filing a petition in the Tax Court. However, we have concerns about any legislative change which would require the Court to go behind the notice of deficiency and review action taken during the administrative proceedings. Such legislation might well have the effect of adding a new issue to a large number of Tax Court cases in which the Commissioner did not concede the exhaustion of administrative remedies. That type of provision would increase the workload of the Court and could be considered counter-productive to our efforts to reduce the pending caseload. Again we support, in principle, a law that would require taxpayers to exhaust their administrative remedies before coming to the Court, and we would be pleased to provide our comments on any specific proposal that the Ways and Means Committee might be considering.

5. Reducing the Number of Cities to Which the Tax Court Travels

In its May 14, 1984 report on the Tax Court, the General Accounting Office recommended that the Court periodically review the need for retaining all of its trial locations. As a result of that suggestion, the Court began phasing out cities in which

only a few small tax cases were heard. We now travel to approximately 80 cities in which taxpayers may try their cases rather than 108 cities, as was the case a few years ago. In determining which cities to remove from the list of places to which we travel, we focused on those cities that were infrequently requested by the taxpayers as a place of trial. Moreover, we eliminated only those cities for which there was another designated place of trial within 150 miles. This was based upon GAO's criterion.

Thus, we have been able to accommodate all taxpayers at a locality relatively close to those cities which have been eliminated. Further, by consolidating cities, we have been able to set cases for trial more quickly. In the past, when a location was selected as a place of trial by only a few petitioners, the Court might have traveled to that city only every other year. Furthermore, it has been less expensive for us to travel to 80 cities rather than the 108 cities which had originally been on our list of trial locations.

In conclusion, we believe that we have been able to accommodate all taxpayers while still complying with our statutory mandate to schedule sessions so that taxpayers may appear before our Court with as little inconvenience as is practicable. Further, we have actually provided taxpayers with an earlier trial date, and have eliminated some travel costs associated with the more extensive travel schedule.

6. Automated Docketing System

The Court's recently implemented automated docketing system has greatly increased the efficiency of processing papers through the Clerk's offices. While this new system does not impact directly on the actual caseload of the Court, the mere volume of paperwork that must be handled on a daily basis requires the assistance of automation. We believe this has been a sound investment on the part of the Court.

7. Assistance of Temporary Personnel to Handle Filings During the Spring and Summer

You have inquired whether the Clerk's Office should hire temporary personnel to handle the increase in case filings that occurs each year beginning in April. In order to manage the paperwork coming into the Court during the spring and summer months, the Court attempts to use permanent personnel to assist in processing petitions. For example, the trial clerks, who normally travel with our judges throughout the year, are available at the conclusion of the spring term, and are, therefore, assigned to the Petitions Section during the summer.

It has been our experience that by using these permanent personnel and allowing employees to work overtime hours, we have been able to handle the thousands of petitions with individuals who are familiar with the Court's operations. We, therefore, do not at this time anticipate that there will be a need to hire temporary personnel.

8. Service of Petitions on the Internal Revenue Service and Prevention of "Premature" Assessments

As a general rule, the Tax Court makes every possible attempt to serve respondent with a copy of the petition filed by the taxpayer within 48 hours of filing. However, during the summer months, there is some delay in serving respondent. During this period of the year, the Court attempts to serve petitions within 15 calendar days of filing which is a time-frame that respondent has stated is sufficient to prevent "premature" assessment against the taxpayer. While premature assessments might occur, on occasion, such occurrences are rare.

CONCLUSION

In conclusion, I would like to note that the Court is preparing some specific legislative proposals which we plan to submit to Congress early this summer. One of these proposals would provide the Court with more flexibility in appointing employees to the Court, and would, we believe, assist us in recruiting law clerks as well as clerical personnel. We would be most grateful for any support that you may choose to give when these proposals are submitted to the Ways and Means Committee.

I hope this information is responsive to the questions raised in your letter of April 29, 1987. Please let me know if you have any further questions.

Sincerely,

Samuel B. Sterrett

Samuel B. Sterrett
Chief Judge

Chairman PICKLE. Charlie, go ahead.

Mr. RANGEL. Next, the Chief Counsel of the IRS, William Nelson, has a statement to make.

STATEMENT OF WILLIAM F. NELSON, CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. NELSON. Mr. Chairman, as a concession to the shortness of life and the nearness of lunch, I will make a few points of embellishment on what Judge Sterrett has said and then answer any questions that you have.

I guess the most significant point about the Tax Court's docket from my perspective is that we not let the absolute size of the docket, which was 84,000 cases at the end of 1986, and is 80,000 now, mislead us.

The question is, are taxpayers getting a fair hearing in a fair amount of time? The fact is that even though the docket has increased by 355 percent in 10 years, the rate at which cases are disposed of is about the same as it was 10 years ago.

What that means is that while there are a lot more cases, taxpayers are moving through the system at relatively the same rate in terms of percentage of the total docket. So, if there were 10,000 cases they would be moving about 4,000 a year, if there were 100,000 we would be moving about 40,000 a year. There is in that sense not a backlog.

It is an increasing docket, and it is an increasing inventory, but it is not a backlog in the sense that there is a funnel where cases are building up and not being moved through the system on an expeditious basis.

Indeed, there are 33,000 cases in the current docket at 10,000 and under, either regular cases or small cases. Eighty percent of those cases are moved within 1 year, and the ones that are not moved tend to be in tax shelters which are part of larger projects. So taxpayers are getting a fairly prompt response, particularly at the lower end of the spectrum. That is the people who have small cases and small issues, and need to have their cases handled in an expeditious manner.

The larger the case, the more time it is going to take. There is just no question about that, and even in the larger case inventory the age of the inventory had not increased appreciably. Indeed, it has decreased over several years.

Tax shelters are a special part of this docket, and we cannot understand this docket if we do not understand the impact of tax shelters. Fifty-five percent—45,000 of the existing 81,000 cases—are tax shelters. In that inventory there are 290 project cases that will control the disposition of 30,000 of those 45,000 cases.

So there are aspects of the absolute number of docketed cases that tend to overstate the impact of the docket as a practical matter.

Now, unlike Judge Sterrett, I think the size of the docket is going to continue to increase in specifically docketed cases over the next couple of years. The reason for that is that there are some 400,000 tax shelter cases still in examination ready to come

through the pipeline, and they will come through and they will be disposed of.

We have announced some procedures in the past two weeks which are intended to settle cases at the examination level without causing the case—I am talking about shelter cases—which are to come through the litigation function. We think that will help slow it down.

But with that volume of shelter cases left in the system, I think the absolute number will go up. I also think that we will continue to be able to provide the rank and file taxpayer, especially the smaller one, with a rapid disposition of his case.

The shelters are starting to move, and when they move they will move in very large chunks. The Court decided a case last week that will settle 1,400 cases at one time. That is pretty impressive when you think about it. There is another case that has been tried and the first round of briefs filed that will impact 3,000 cases when that case is decided.

A lot of cases will move that way.

My own view is that the docket will continue to increase for a couple of years, that it is under control, and that if the anti-tax shelter provision of the 1986 Act can be successfully implemented the glut of tax shelters will dissipate. The docket will then come back into an absolute number of cases that will more accurately reflect the actual case load that is imposed on every lawyer.

Now, having said that I will be happy to respond to any questions that either one of you may have.

[The statement of Mr. Nelson follows:]

STATEMENT OF WILLIAM F. NELSON, CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. Chairman and Members of the Subcommittee: I am pleased to be with you today to discuss the Chief Counsel's office and the steps we are taking to manage the Tax Court inventory. In my testimony, I will focus on the management initiatives and programs we have implemented to carry out our responsibilities.

With me today is Mr. Jean Owens, Deputy Chief Counsel for Management and Operations. We will be happy to answer any questions you may have at the conclusion of this statement.

Mr. Chairman, to begin my testimony, I would like to provide a brief overview of the Tax Court inventory and to suggest a perspective for analyzing the inventory.

At the end of FY 1986, there were 83,686 cases pending in the Tax Court, an increase of 355% over the inventory at the end of FY 1976. The situation is not, however, as dire as the numbers might indicate. While I do not want to minimize the challenges of dealing with this inventory, I believe there is no cause for alarm. Indeed, the resoures requested for the Office of Chief Counsel are appropriate to the task at hand.

The growth in the Court's inventory during the past decade was accompanied by a 321% increase in "receipts"—our term for petitions filed with the Court. Given this increase in receipts, a parallel increase in inventory is to be expected. Rather than looking at the inventory levels in the abstract, it is more appropriate to focus on the rate at which cases move through the litigation process. Are cases moving through the system—to trial or settlement—at an acceptance pace?

The answer to this question, we think, is "yes". Of the cases included in the Court's beginning inventory, approximately 40% are closed during the year. This closing rate is similar to the closing rate of ten years ago. While the rate fell slightly in FY 1985 and FY 1986, we expect to see the closing rate increase this fiscal year. In fact, disposals for the first six months of FY 1987 have increased 16% over those for the first six months of 1986. We think this increase is attributable to a new "first in, first out" calendaring process, better management by the Court, and our efforts to move related tax shelter cases in organized projects.

OVERVIEW OF CASE PROCESSING; THE APPEALS BYPASS PROBLEM

Before dealing with specifics, I would like to provide a brief summary of how a case comes before the Tax Court.

If a taxpayer disagrees with a proposed deficiency, as determined by the Examination function, he or she has two choices. First, the taxpayer can request an administrative appeals conference with one of our Appeals Officers. Appeals Officers settle more than 85% of all cases they consider during the administrative process. Of course, a case settled by Appeals during the administrative process never becomes part of the Tax Court inventory.

Alternatively, the taxpayer may forgo the opportunity for an administrative appeal, in which case the Internal Revenue Service has no choice but to issue a statutory notice of deficiency, or 90-day letter, which is the taxpayer's "ticket to the Tax Court." If the taxpayer files a petiton with the Court, the case is docketed and our office is required to "answer" the petition. However, we return virtually all docketed cases to the Appeals Division which considers them in the same way that nondocketed cases are considered. Thus, whether the taxpayer chooses the administrative appeal route or the docket approach, he or she will generally have the opportunity to be heard by an Appeals Officer. Significantly, Appeals disposes of cases in both categories with equal facility. In general, our lawyers become actively involved in a case only if Appeals cannot settle it.

In recent years, taxpayers have shown a propensity to bypass their right to an administrative appeal in favor of docketing their case and then talking to an Appeals Officer. More than 80% of the Court's FY 1986 receipts resulted from these cases. The result is that the docket is inflated by cases that should not be there and would be settled administratively if we were given the chance.

Appeals bypass is more than a nuisance that overstates the "real" Tax Court docket. It is expensive for us since paper must be moved and lawyers must answer all petitions in regular cases. It is simply a waste of legal talent to force lawyers to become procedurally involved in a case that should be disposed of administratively. While Congress amended section 6673 in the 1986 Tax Reform Act to help deal with the bypass problem, and we welcome the help, I personally do not believe the legislation will solve the problem.

TAX SHELTERS

Now let me turn to another major issue that affects the docket—tax shelters. Approximately 45,000 cases, some 55% of the Court's inventory, are tax shelter cases. These cases, which virtually did not exist ten years ago, tend to involve large numbers of investors in the same promotion, with each case involving similar factual and legal issues.

In 1984, the Office of Chief Counsel developed a "project" approach to tax shelter litigation. Under this approach, investor cases involving the same tax shelter promotion and common factual and legal issues are treated as a single project. The project is assigned to a single attorney or team of attorneys and a key case Appeals Officer. They are responsible for resolution, by settlement or trial, of all issues with respect to the promotion. Typically, a consistent settlement offer is made to all investors, and a test case or group of test cases are prepared for trial. In many instances, we request that the project be assigned to a single Tax Court judge who will conduct all trial and other necessary proceedings for the project, thus reducing the need for duplicative trials. There are now 292 tax shelter litigation projects which control approximately two-thirds of all docketed tax shelter cases. In addition, these cases will control thousands of additional cases that are in nondocketed Appeals status or in Examination. The important point, therefore, is that a relatively few test cases will permit us to dispose of an enormous number of individual cases.

In addition to the project approach, on April 16, 1987, the Internal Revenue Service announced a tax shelter settlement initiative under which Examination personnel will be able to offer taxpayers the same settlement being made by Appeals and Counsel. We hope to save both taxpayers and the Government the time and expense of processing cases to litigation by making the same settlements available throughout the administrative and litigation process. The initiative generally applies to pre-1982 investors, but may be expanded in the future. This initiative will not have an immediate effect on Tax Court inventory, but, like preventive medical care, will help keep the patient healthy.

WESTERN REGION GROWTH

Although all regions have experienced growth in Tax Court inventory in recent years, the largest increase has been in the Western Region, particularly in Southern California. Western Region inventory has grown by more than 700% during the past decade. Ten years ago, the Western Region accounted for 25% of the Tax Court inventory, with the Southern California office accounting for 13%. The Western Region now accounts for 43% of the Court's inventory, with the Southern California offices (now three in number) accounting for 24%.

We have sought to address the shift in cases to the Western Region in two ways—by increasing staff in the Western Region and by transferring groups of tax shelter project cases to attorneys in other regions. The increase in staffing has been accompanied by the opening of new Western Region district counsel offices, including offices in San Diego, Laguna Niguel, San Jose, Sacramento, Honolulu, Las Vegas and Anchorage.

There are impediments to responding to increases in Tax Court workload. The inability to obtain additional office space within a reasonable period of time sometimes prevents us from expanding an office as rapidly as necessary. In addition, the last few years have seen a decline in the number of qualified attorneys applying for jobs throughout the Office of Chief Counsel. We believe this is attributable in large part to the increasing disparity between starting salaries offered by the private sector and those offered by the Government. While we believe the staffing levels which we are seeking for FY 1988 can be realized, they constitute the outer limit of our ability to increase staff and maintain quality.

ROLE OF APPEALS

As I have already indicated, the Appeals organization plays a critical role in resolving tax disputes, reducing the number of cases that would otherwise be filed in the Tax Court. I am proud of the settlement record of our Appeals Officers, who settle more than 85% of the unagreed cases coming before them. In a 1986 taxpayer attitude survey conducted by the Service, taxpayers expressed satisfaction with their experience before Appeals.

As you know, the Commissioner is emphasizing taxpayer service and is trying to make the IRS more "user friendly." Our Appeals function has been providing quality service for over 60 years. It is vital to our ability to deal with Tax Court inventory and is widely respected by Taxpayers and their representatives.

"S" CASES

The Court's small tax case procedure affords taxpayers an opportunity for a quick and informal hearing before a special trial judge, without the need for an attorney. The procedure may be elected by a taxpayer if the amount in dispute for each tax period is $10,000 or less. At the end of FY 1986, there were 12,028 "S" cases pending before the Court. Since 1981, "S" case receipts and disposals have been approximately equal, and inventory levels have remained in the 10,000–12,000 range.

The Office of Chief Counsel has emphasized the efficient disposition of "S" cases by monitoring the amount of attorney time spent on these cases and by utilizing paralegals, supervised by attorneys, prior to trial. We are proud of the fact that small cases move through the system very efficiently.

FOCUS ON QUALITY

In managing the inventory, we must not let our concern over case disposals detract from the need to maintain high standards of quality in the Office of Chief Counsel. While it is appropriate that we set objectives for case disposals in each region, we must also focus on the need to devote sufficient time and attention to significant cases in the Court's inventory. These cases may be significant because of the amount of tax involved or because they involve industry-wide issues or otherwise affect large numbers of taxpayers. Recent quality initiatives include the creation of an industry specialization program, the special trial attorney program, and the informal technical advice program.

Established in 1985, the Chief Counsel Industry Specialization Program provides informed, practical and expedited legal support to the Examination function. Teams of attorneys in both the field and National Office are assigned to each of 16 industries. The industry teams develop expertise in business and legal issues affecting the industry, give advice on the proper development of issues, and may litigate or assist in the litigation of issues affecting the industry.

The special trial attorney program was established in 1980. Under this program, a cadre of senior litigation specialists try the most sensitive, significant and complex Tax Court cases. These cases may involve large deficiencies or issues affecting large numbers of taxpayers.

The informal technical advice program allows district counsel attorneys to discuss legal issues over the telephone with an attorney in the Tax Litigation Division. During FY 1986, Division attorneys responded to more than 4,000 requests for informal technical advice.

CONCLUSION

Mr. Chairman, my associate and I will be pleased to try to answer any questions that you or the members may have.

Mr. RANGEL. Do you feel comfortable in responding to the cuts that the Administration made on the IRS budget request?

Mr. NELSON. The IRS request as it applies to the Office of Chief Counsel, which is lawyers and appeals officers? Yes, sir, I think that the budget is absolutely adequate.

Mr. RANGEL. I am saying that I have information that the Administration increased the budget but reduced the request by some $28 billion.

Mr. NELSON. For the Office of Chief Counsel? In fact, we got what we asked for. There are some absorption items in that budget which add up to $30 million, something of that nature. The answer to the question—and this is not because somebody tells me I have to say it—is that if I get what is budgeted in the Administration budget, I will have as much money as I can profitably, intelligently spend.

The handling of the docket, the producing of regulations, and so forth, require as much management as it does money at this point and I am really very satisfied with that budget.

Mr. RANGEL. Well, why would you ask for $28 million more than you needed?

Mr. NELSON. Well, for one thing I was not here when they asked for it; but having said that, I asked that very same question myself, and there are a couple of answers to that question, Mr. Rangel.

The first one is that when we started to put that budget together, the project approach to tax shelters was still in its formative stages. We have found that the project approach is much more efficient than we frankly had any right to expect it to be, and we are doing a whole lot more with a whole lot less than we expected.

The second one is that we have found—focusing on the smaller cases, which as I have indicated are 33,000 cases, less than 1 percent of the assessed revenue—that it is simply not appropriate to put a lot of lawyers on those cases. They are much more effectively moved with paralegals who do not cost as much money.

So we will move those cases in the system up to the point of trial—and we rarely get to trial—with paralegals. The fact is we can spend what we are getting. We will be hiring aggressively, and I am personally quite satisfied with what we have got this year.

I am not saying that in two or three or four years that we might not be able to absorb some more, but in terms of the point in the year at which we are, the time at which we would receive an authorization to begin to hire, the time it takes to expand the agency—and we are growing faster than just about any law firm in the country—the time it takes to get the space and make the com-

mitments, it would be very difficult for us to do more than what we can do with what we have.

Mr. RANGEL. Well, the Committee normally ignores the Administration and appropriates from what they think is necessary in order to collect what is due the Federal Government, and each time there has been a balloon of affirmative response to that in terms of the money being appropriately used, and each Commissioner, Republican or Democrat, has lauded the Congress for responding when the Adminstration did not.

I do not know what the Appropriation Committee intends to do this year but your testimony clearly says that if they did spoonfeed you the money, you could not use it.

Mr. NELSON. I am saying that the amount of money that we are scheduled to receive is adequate for our purposes, and I am also saying that we will be able to generate the revenue that the Administration expects with that money. I do not believe that there will be any significant decline in the number or the volume of cases closed as a percentage or as an absolute number because of that.

Mr. RANGEL. Mr. Chairman?

Chairman PICKLE. Well, you seem to be in agreement with Judge Sterrett and the Tax Court that everything is under control

Mr. NELSON. Yes, sir. I really do believe it is under control, and it will get up—I will make a prediction—we will nudge 100,000 cases in the next couple of years. The question is, will we continue to move them. At the same percentage rate that we are currently moving them? As long as I can give small taxpayers in this country a turn around time of less than a year and move these shelters at the rate at which we are moving them—we have now tried 47 major shelter projects——

Chairman PICKLE. You have given the timetables out in the field then?

Mr. NELSON. Yes, sir. We use management by objectives, and we do, in fact, tell the field within a tolerance what we expect them to do in terms of closings. Now, I have got to tell you that I have a lot of trouble telling a lawyer that he has got to work by the numbers. Quality is very important in our organization, but particularly at the low end where you have got so many thousands of taxpayers with such relatively small amounts of money involved.

As I said, with 40 percent of the docket and less than 1 percent of the revenue, those cases have to be managed by the numbers, and that is the way we do it.

Chairman PICKLE. Well, I think we have to be concerned somewhat with our own consistency when we concern ourselves about the large number of cases, and they are growing. You ought to do something about them. Though we would call them backlogs and you just term them regular growth, whatever we term them, you have given a goal, quantitative and qualitative goal, for them to achieve.

Mr. NELSON. Yes, sir.

Chairman PICKLE. Now, it concerns me also, though, that when you give them these goals and you say to them they have got to settle these cases as quickly as possible, and when they do that, are you not running the risk of "giving away the store" in effect?

Mr. NELSON. I do not think so.

Chairman PICKLE. Well, I thought you just got through saying that it bothers you——

Mr. NELSON. No. I think that from my end—let me talk about giving away money again. Let me emphasize that 33,000 of those cases are for less than $10,000, and that is less than 1 percent of the total assessed revenue. Those cases are relatively simple, and frankly, we overmatch the taxpayer in those cases by a substantial amount.

I do not think we are giving away those cases, and we do not expect and will not expect in the next cycle to have case closing goals as such in the larger cases. We have 1,400 cases that account for 80 percent of the assessed revenue. That is where the money is and that is where you pour the quality in this system. Other than that, the taxpayer deserves to be heard quickly and moved.

Chairman PICKLE. I am not saying that you are sacrificing quality, but it concerns me when you set a goal and you have agreed with that concern.

Mr. NELSON. Absolutely.

Chairman PICKLE. We will have to be watching to see whether you do that or not.

You say you do not need more personnel.

Mr. NELSON. No. We need what we are budgeted to get, now. I did not say that.

Chairman PICKLE. Well, lets review that. You are going to receive about $28 million less than what the IRS had originally asked for.

Mr. NELSON. Yes, sir.

Chairman PICKLE. And if IRS asked for $48 million for personnel and so forth, I assume IRS did it because you asked them to request it for you. I do not think IRS just picked it out of the air and just said, hey, something tells me that we ought to ask for $48 million, so I assume that you made that request.

Now, you did not get it?

Mr. NELSON. No, sir.

Chairman PICKLE. So I ask the natural question then, how is that going to hurt your operation, because you wanted that many more personnel, you did not get them. Yet, you say everything is going just fine, we do not need it.

Mr. NELSON. I think as I answered Mr. Rangel a while ago, the preparation cycle on those budgets occurs a long time in advance. We are now much more efficient in the way we are handling project tax shelter cases. We are now making much greater use of paralegals than we have in the past. That cuts a lot of it out, and frankly, when we do not know what we are getting until very close to the beginning of the fiscal year, it is very difficult to spend the money.

If we had known a year ago that we were going to get that much money, maybe we would be able to do it, but the practical fact is that we are in a situation where I think we are——

Chairman PICKLE. Well, it seems to me that a natural question that follows is how would you have used such additional funds to reduce this large number of cases if you had gotten them? You had asked for that money and you did not get it, and maybe you were

asking for more than you could really expect, but in this day and time I doubt that.

The fact of the matter is you did not get a considerable amount of money that you had requested.

Now, let me ask you one or two more questions. You stated that the Western Region accounts for 43 percent of the Tax Court's case load?

Mr. NELSON. That is correct.

Chairman PICKLE. Now, are 43 percent of your lawyers stationed in the Western Region?

Mr. NELSON. No, sir.

Chairman PICKLE. If not, why not?

Mr. NELSON. Well, we have been moving lawyers to the Western Region, and appeals officers too, by the way. We have to recognize that most of the docket is handled by appeals officers and not by lawyers. Cases are closed by appeals officers, principally.

We have opened several offices in the Western Region and we are moving people there as fast as we can. Each office of District Counsel is like an independent branch of a law firm. There is a limit to the number of people that we can hire and absorb and house in a region in a very short period of time.

Now, we are doing two things to deal with the Western Region. One is opening new offices and transferring personnel in. The other is that we are transferring cases out of the Western Region, particularly tax shelters.

What we find is that we can take a project shelter that might otherwise come out of Los Angeles and move it to Louisville, for example, where the case load is not as significant and where we have lawyers with the time and experience to deal with the case. So we are both moving people in and we are moving cases out.

It is not possible nor do I think it is good management to take the rest of the country and transfer those people to the Western Region in order to deal with a specific problem.

Chairman PICKLE. What about the possibility of dividing the Western Region into two regions?

Mr. NELSON. That is certainly a possibility, but I do not think that really solves much of the problem.

Chairman PICKLE. It would reduce the enormity of a single region.

Mr. NELSON. Well, of a single region, but you would still have the same number of lawyers dealing with the same number of cases. If we divide it in two, we would just have two smaller pieces.

Chairman PICKLE. Well, that is true, but on that basis you could say to just have one region for the whole United States. You do not do that. You break it down into more effective administration.

Mr. NELSON. But let me also point out to you that of the 43 percent that is in the Western Region, 24 percent of the total is in Southern California by itself. I mean, we have actually given some consideration to carving off the southern part of California and calling it a region, which might make some sense, and indeed in the past we have moved a couple of states. I think we moved Utah from Western to Southwest in the past couple of years to do that, and we may end up having to do that, to split the regions, but it will not solve the big problem

Chairman PICKLE. Well, that may be a viable alternative, I do not know. We are just trying to find some way to reduce the volume if it is not a backlog.

Mr. NELSON. Well, I will say that overall it is not a backlog. But I want to be candid with you. The problem in this country right now, really, as far as the Tax Court's docket and our ability to deal with cases, is in Southern California. There I would freely concede that there is a backlog, and we are working on that problem as hard as we can work on it.

But what we do not require is an addition to the gross number of staff years that we have. What we have to do is get staff years to California or get cases out of California, so those people get the kind of service they deserve.

Chairman PICKLE. Well, whether you are in the Western district or any one district, taking a complex case through the appeal division can be a long and expensive process. What are you doing to try to encourage a taxpayer to take a case to administrative appeals before he actually files a case? Is there any work being done to encourage them to take that route instead of just filing the case?

Mr. NELSON. Well, yes. I go out and make speeches and exhort people to go ahead and use their administrative appeal right rather than docket their case. The fact of the matter is that one other reason that the Tax Court's docket is bigger than it ought to be is that taxpayers persistently bypass their right to a non-docketed administrative appeal. Eighty percent of the docket consists of taxpayers who did not go to the administrative appeals function first.

What we do when they are docketed is we then have to answer the case, which gets a lawyer involved, but then we kick it right back down to the same appeals officer who would have been hearing the case if they had proceeded administratively. We give that appeals officer settlement jurisdiction over the case in order to move the case, and indeed they move those cases as docketed cases about as fast as they do in the non-docketed case. The problem is that lawyers perceive significant tactical and procedural advantages to docketing cases.

The Congress gave us some additional help in code section 6673, I think it is, in the 1986 act, which permits the Court to impose a penalty for frivolous bypass of the administrative appeal right.

It is unfair for me to reach conclusion about the effectiveness of that provision because we do not have enough experience with it yet. But I can tell you my prediction—and I would put a fair chunk of money on it—is that it is not going to help us very much, although we welcome any help, because there are undeniable reasons right now from a procedural standpoint that makes some lawyers prefer to go ahead an docket a case.

That is a problem we are dealing with and we may well be back to you with some legislation on that. If we get it, we would like for it to be simple, straightforward and concise—but also to put people in a position where there is some cost to bypassing and going straight to docketed status.

Chairman PICKLE. Well, we will want to get these regular reports from you. One would be the timetable. We would like to know your timetable for resolving the 290 projects that you said you have organized now for handling these things.

Mr. NELSON. We would be glad to give you that. In fact, I do not think it is in the prepared testimony, but there is a breakdown to some extent in the April 17 letter that we sent you responding to some questions that you asked. It shows you how many cases we have got, how many are ready for trial, how many are tried, how many are waiting opinion, and what have you. And we can give you a timetable on that.

Chairman PICKLE. Well, we would like to have that.

Mr. NELSON. There will be more projects open, by the way.

[The information was not received.]

Chairman PICKLE. Incidentally, why is there such a big backlog, or such a big volume of cases in the Western division?

Mr. NELSON. I do not know the answer to that question.

Chairman PICKLE. A big hunk of that is in Southern California. Are Californians just unwilling to pay taxes?

Mr. NELSON. I really do not know the answer to that question, Mr. Chairman. There obviously is a large concentration of population, there but the fact of the matter is that the agreement rate among taxpayers who are audited out there is lower than it is in the rest of the country. I am not a sociologist. I cannot tell you what the answer to that question is.

Chairman PICKLE. Well, we are not sociologists either, but we are trying to find some way to move this along a little faster and a little better. Yet, your general testimony is that the thing is going well and you do not need a lot of help, you just need more time?

Mr. NELSON. We need what we have got and we need some time, and we need to manage well.

Chairman PICKLE. Well, I agree with you on that and I think the points that Judge Sterrett was making about management may be a big help. But between his operation and your supervision, or however they are coordinated, we are going to be looking into this whole question further as we go along. A year from now, or less, we are going to take another look at this and see how we are doing.

Mr. NELSON. That is good. We look forward to it.

Chairman PICKLE. All right. Thank you.

Now, Mr. Rangel, do you have any other questions? Staff?

Well, Mr. Willie Nelson, we thank you.

Mr. NELSON. Yes, sir. Thank you.

Chairman PICKLE. We appreciate you appearing before us. Thank you very much.

If there are no other questions then the committee will stand adjourned.

[Whereupon, at 1:55 p.m., the hearing was adjourned.]

APPENDIX

ONE HUNDREDTH CONGRESS
DAN ROSTENKOWSKI, ILLINOIS, CHAIRMAN

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ALL SINGLETON, MINORITY CHIEF OF STAFF

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

May 8, 1987

The Honorable Edward R. Roybal
Chairman, Subcommittee on Treasury,
  Postal Service and General Government
Committee on Appropriations
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On April 23, 1987, the Subcommittee on Oversight of the Committee on Ways and Means held a hearing to examine the Administration's Fiscal Year 1988 budget proposals relating to the staffing and funding levels, as well as the allocation of resources, of the Internal Revenue Service (IRS). In response to the clear consensus of testimony at the hearing and in keeping with the deep concerns and interests shared by the two Subcommittees in recent years, we are writing to recommend that the FY 1988 IRS appropriations bill now under consideration by your Subcommittee be increased by approximately $57.8 million and 1500 positions, to correct a serious deficiency in the Administration's budget proposal, Taxpayer Service.

As you well know, the FY 1988 IRS budget request totals $5.07 billion and 110,661 average positions. This is an increase of $624.9 million and 9,463 average positions over FY 1987 levels. After suffering from years of inadequate funding, we are encouraged that the Administration apparently is recognizing the need to have a first-rate IRS, the primary revenue-raising arm of the Federal government. We are concerned, however, that the Administration's approach, with its virtually complete focus on enforcement, may lead to a one-sided, unbalanced Internal Revenue Service. The implementation of tax reform demands our particular attention--and certainly IRS's--in FY 1988.

In light of our particular concerns, it is especially interesting to note that the Administration's FY 1988 budget proposal for the Internal Revenue Service is $724 million and 8,969 positions less than the IRS requested. The Taxpayer Service program, particularly, is funded and staffed at a level significantly lower than that requested by the Internal Revenue Service, and below actual FY 1987 levels. Our recommendation, therefore, is designed to address one of the more pressing problems that remain unresolved under the Administration's budget proposal--a problem that, no matter what enforcement initiatives are presented, could lead to a further decline in taxpayers' confidence in a fair and efficient IRS, and hence, ultimately, in our voluntary compliance system.

We believe that additional funding for IRS should be directed first to Taxpayer Service, in the amount of approximately $57.8 million and 1,500 additional positions. With such additional support, IRS would increase the level of toll-free telephone assistance from the proposed 65% level to an 85% level. IRS itself considers an 85% level to be the optimal level of taxpayer telephone assistance, that is, 85% of all taxpayers that try to reach IRS by telephone would ultimately prevail. Under the proposal, IRS would be able to better train its Taxpayer Service employees, thus improve the accuracy of responses received by taxpayers, be prepared to deal with the large number of inquiries relating to tax reform changes affecting tax years 1987 and 1988, and also devote more resources to taxpayer correspondence.

In comparison to FY 1987, the Administration's FY 1988 proposal would result in a decline in the number of Taxpayer Service positions (-191 positions), the number of taxpayers assisted, not including tele-tax contacts (-4.8 million), and in the level of service (from 78.7% to 65%). (This decline takes into account the transfer of 500 additional staff into Taxpayer Service in FY 1987.) We must reverse this dangerous course of action.

Every witness at the Oversight Subcommittee's hearing, including former IRS Commissioners Egger, Kurtz, Alexander, and Cohen, strongly urged greater funding for Taxpayer Service. As taxpayers seek to comply with tax reform, and grapple with the myriad of new rules, new definitions, new forms, new reporting requirements, etc., they are going to call on the IRS for help. This is a fact of life. Taxpayers

should be able to get prompt and adequate assistance from the Internal Revenue Service. Taxpayers expect it. The Congress expects it, too. Demands regarding tax reform in FY 1987 alone necessitated IRS's transferring an additional 500 staff into Taxpayer Service. Surely the demands in FY 1988 will be greater, yet the Administration's proposal cuts back on this essential service.

We remain firmly convinced that IRS has a responsibility to promptly and meaningfully assist taxpayers as they try to comply with our Federal tax laws. The degree to which IRS has sufficient resources to meet this obligation has a very real impact on the level of voluntary compliance with these laws. Voluntary compliance, after all, is the very cornerstone of this nation's system of taxation.

In addition, we recommend that your Subcommittee carefully examine the needs and priorities of Returns Processing, the Problem Resolution Program, and the Exempt Organizations function. Information developed at the Oversight hearing identified these functions as ones which did not receive full Administration attention and support. Additional funding in these areas could result in IRS:
(a) undertaking new initiatives to advise taxpayers of errors, and improve quality in Returns Processing;
(b) improving the operation of the Problem Resolution Program, in both the National Office and the field offices, including a greater commitment to identification of recurring problem areas requiring Service-wide attention; and,
(c) improving the operation of the exempt organization function, including reversal of the Administration's proposed decline in the examination rate.

We also would like to address three additional points regarding the budgetary needs of the Internal Revenue Service. First, we are aware of IRS's request for a five percent transfer authority to cross appropriations account lines. While we recognize, on the one hand, IRS's need to respond quickly and competently to unanticipated shifts in work load and backlogs, we are concerned that such authority would allow the Administration to continue to understaff the Internal Revenue Service, and try to get by with certain staff doing two jobs, or not doing the job they were hired to do. We are concerned that something may be sacrificed as employees are shifted from one problem area to another. What job were they doing that won't be done now? Could this lead

to a reduction in taxpayer service, or examinations, or collections? To respond to these concerns, we would suggest that your Subcommittee consider adding, if you decide to approve such transfer authority, a requirement that IRS report any exercise of this authority to the tax-writing and appropriations committees on a quarterly basis.

Second, in response to problems encountered by the public and the Internal Revenue Service, the Oversight Subcommittee has held numerous hearings on various aspects of the Internal Revenue Service's computer operations. Automated data processing and information systems account for about $847 million or 17 percent of the Service's total FY 1988 budget. Furthermore, the Service plans to make increasing use of, and to become increasingly reliant on, computer technology in the future. Because these initiatives are not separately reported in the Administration's budget request, it has been difficult to follow the evolution of the Service's computer automation plans. Therefore, we would recommend that, as part of their annual budget submission, the IRS be required to describe the functional objective and the anticipated budget requirement for each major project, including any significant changes in anticipated spending for previously funded projects.

Finally, at the hearing, the Subcommittee considered both the IRS's and Tax Court's efforts to reduce the backlog of U.S. Tax Court cases. In FY 1986, the number of cases filed, cases closed, and cases pending at the end of the year were the highest in history. The 83,686 cases pending at the end of FY 1986 involved deficiencies of over $16 billion. These statistics, and data showing a 600% increase in Tax Court cases pending, resulted in legislation requiring periodic reports to the Committee on Ways and Means relating to the backlog. The first interim report of the Tax Court shows that, as of April, 1987, the inventory has increased to over 100,000 cases and deficiencies of approximately $21 billion. The IRS Chief Counsel and the Chief Judge of the Tax Court reported to the Subcommittee that new management initiatives were being implemented to deal with the growing inventory backlog. Nonetheless, the Subcommittee suggests that your Subcommittee consider steps within its jurisdiction which would reduce the backlog of cases even further. The IRS Office of Chief Counsel reports that the purchase of certain ADP equipment would result in 1,200 additional case closings by FY 1989 and $33 million per year

in accelerated revenue. The Tax Court requests an increase in the total number of permanent positions for FY 1988, from 339 positions to 350. This change would improve case closings, with costs absorbed within the proposed FY 1988 budget.

In closing, we would like to direct your attention to "The Report of The Dorgan Task Force on Narrowing the $100 Billion Tax Gap", which has been submitted to you. This is a commendable document and is worthy of careful consideration by your Subcommittee.

We appreciate this opportunity to again work with you on this matter of critical importance to fair, equitable and effective tax administration.

Sincerely yours,

Dan Rostenkowski, Chairman
Committee on Ways and Means

J. J. Pickle, Chairman
Subcommittee on Oversight

Beryl Anthony, M.C.

Ronnie G. Flippo, M.C.

Harold Ford, M.C.

Charles B. Rangel, M.C.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

APR 8 1987

The Honorable Edward R. Roybal
Chairman, Subcommittee on Treasury, Postal
Service, and General Government
Committee on Appropriations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

As requested by the Committee on Appropriations, the Service has prepared a Five Year Resource Plan, under circumstances set forth by the committee, aimed at reducing the tax gap through increasing the level of voluntary compliance among taxpayers; dealing with special compliance problems; ensuring an effective level of taxpayer services; and maintaining balance among functional programs to prevent backlogs.

This plan, in addressing the committee's request, would allocate any additional resources above the President's FY 1988 budget request first to provide a higher level of taxpayer services, second to maintain and improve balance among functional programs, third to deal with special compliance problems, and fourth to increase examination and collection programs.

Current audit coverage and the costs of implementing the Tax Reform Act of 1986 are provided in the plan.

I sincerely apologize for the delay in providing this plan. We have been endeavoring to include updated tax gap estimates; however, we have not yet completed reviewing the preliminary data. We will provide final estimates when we have completed our review.

I appreciate the interest and support that your subcommittee has given to provide funding for the Service to continue to administer the nation's tax laws fairly and adequately. I hope this plan is useful; I would be pleased to answer any questions you may have about it.

With best regards,

Sincerely,

Enclosure
Five Year Resource Plan, FY 1988-FY 1992

Internal Revenue Service

Five Year Resource Plan

FY 1988 - FY 1992

A Special Report Prepared at the Request Of
The Committee on Appropriations
U. S. House of Representatives

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Attachments

Attachment 1 - Committee Request

Attachment 2 - Commissioner Gibbs' September 22, 1986, Letter to Chairman Pickle.

Attachment 3 - Charts
- Scenario One - Additional Collection and Examination Resources
- Scenario Two - Additional Collection and Examination Resources

Summary

In July 1986, the House Appropriations Committee requested the Service to prepare a five year [resource] plan that addresses reducing the tax gap, increasing the level of voluntary compliance, dealing with special compliance problems such as overseas tax havens, ensuring an effective level of taxpayer service, and maintaining balance among functional programs. The plan in brief:

I. Limitations and Working Assumptions

- Six limitations and working assumptions were identified by the Service in developing this plan.
- Foremost, the plan is predicated on the Service receiving additional staffing beyond current FY 1988 budget plans.

II. Current Audit Coverage

- Audit coverage is projected to increase from 1.6 percent in FY 1988 to 1.73 percent in FY 1992.

III. Additional Resources and Expected Performance

- Additional resources would first be used for improving the level of taxpayer service, second for maintaining balance among functional programs, third for dealing with "special" compliance problems, and fourth for expanding Examination and Collection programs.
- Two scenarios of additional resources are included in this plan, one which maintains expenditures at the low end of the 2,500-5,000 additional average positions per year (for five years) range specified by the Committee, and one which allows maximum growth in Service programs within the specified range. The difference between the two scenarios is the level of staffing devoted to expanding Examination and Collection programs.

- Both scenarios would increase the level of taxpayer telephone service from 65% to 85% and make quality and efficiency improvements in the Taxpayer Service Program; provide a balanced examination program for employee benefit plans; provide for an additional 17.6 million annual notices informing taxpayers of delays in return processing and the causes for the delays; provide a balanced management audit and integrity program; provide additional staffing for Criminal Investigation's General Enforcement Program to replace funding diverted for priority projects; and provide additional resources for the international tax administration and the Tax Haven Offshore Bank Project.

- Scenario one would expand Examination and Collection compliance programs by 9,457 additional average positions by the fifth year of the plan, generating revenue streams totaling $6.4 billion ($5.5 billion collected through FY 1992 and the remainder collected after FY 1992). Audit coverage would increase from 1.61 percent in FY 1988 to 2.01 percent in FY 1992.

- Scenario two would expand Examination and Collection compliance programs by 19,291 additional average positions by the fifth year of the plan, generating revenue streams totaling $11.7 billion ($9.5 billion collected through FY 1992 and the remainder collected after FY 1992). Audit coverage would increase from 1.6 percent in FY 1988 to 2.06 percent in FY 1992.

- All estimates for expansion of Examination and Collection programs include costs for support and "follow-on work" generated by expansion of these major compliance programs, and performed by other Service functions.

IV. Costs of Implementing the Tax Reform Act of 1986

- FY 1987 - 932 additional average positions and $80 million.

- FY 1988 - 1,032 average positions over the 932 in 1987, for a total of 1,964 additional average positions, and $80 million.

Internal Revenue Service Five Year Resource Plan

Background

The House Appropriations Committee Report for Fiscal Year 1987 (Report 99-723, dated July 30, 1986) requests that the Service provide an annual "five year [resource] plan" to assist in allocating future resources (Attachment 1). The Committee asked that the five year resource plan be aimed at reducing the tax gap through:

- o Increasing the level of voluntary compliance among taxpayers;
- o Dealing with special compliance problems such as overseas tax havens, abusive tax shelters, and tax fraud.
- o Ensuring an effective level of taxpayer services;
- o Maintaining balance among functional programs to prevent the emergence of backlogs such as those now existing in Appeals, regulations, and taxpayer delinquent investigations.

Introduction

The five year resource plan presented here focuses on the identification and correction of areas of noncompliance and maintaining a balance among Service programs.

The plan is organized in four sections as follows:

I. Limitations and Working Assumptions

The six limitations and working assumptions used as a basis for developing this plan are discussed in this section.

II. Current Audit Coverage

This section contains audit coverage under current policies and programs reflected in the President's FY 1988 budget.

III. Additional Resources and Expected Performance

A strategy for how the Service would use an additional 2,500 to 5,000 average positions per year (above the current budget) for each of the next five years is described in this section, accompanied by estimates of performance such as revenue return, audit coverage, additional cases initiated,

additional notices mailed, etc. The section is divided into subsections:

A. Overview
B. Taxpayer Service Program
C. Maintaining Balance Among Service Programs
D. Special Compliance Problems
E. Examination and Collection
F. Summary Tables

IV. Cost of Implementing the 1986 Tax Reform Act

This section contains the resource requirements for implementing the Tax Reform Act of 1986.

I. Limitations and Working Assumptions

In developing the plan, several limitations were identified and working assumptions were established. They are as follows:

A. The plan is predicated on the Service receiving additional staffing beyond current budget plans and it addresses how the Service would expend these resources. All average positions reflected in the plan are in addition to those in the FY 1988 budget and the outyears reflected in that document. This includes an additional 2,500 FY 1989 average positions for Examination which the Committee has tentatively approved under a multi-year Revenue Initiative.

B. To provide estimates and projections to the Committee in the agreed upon time frame, estimates and projections in this plan are based on the Service's FY 1988 budget request which has not yet been approved by Congress. If, during Congressional consideration, substantial changes are made to the FY 1988 IRS budget request, the staffing and revenue projections herein will have to be revised.

C. The current (FY 1988) budget request includes sufficient staffing for the timely processing of all tax and information returns, and response to all taxpayer queries, with a 65% level of telephone service. (Note: The FY 1987 budget request provided for a 65% level of service; resources were subsequently redirected to provide a 75% level of service.) Staffing beyond the President's FY 1988 budget request would first be used to provide a higher level of taxpayer service, second to maintain and improve balance among functional programs, third to deal with "special" compliance problems, and fourth to increase Examination and Collection programs.

D. The strategy for using additional average Examination and Collection positions above the current program level is limited by the Service's ability to assimilate (recruit, train, and deploy) additional staff. Under a current revenue initiative, Examination already anticipates receiving 2,500 additional average positions in both FY 1988 and FY 1989. In addition, under the current FY 1988 budget request, Collection anticipates receiving 2,970 additional average positions (for accounts receivable work) and the Information Returns Program (IRP) anticipates receiving 1,360 additional average positions. The number of additional average positions that can be assimilated in FY 1988 and FY 1989 by Examination and Collection is, therefore, limited. The 1,360 additional average positions for the Information Returns Program in the FY 1988 budget would provide a staff level which would meet all current and near-term needs. In developing this plan, the Service reconsidered and in some cases updated the assimilation levels previously provided to Chairman Pickle in September 1986 (Attachment 2).

E. Increased activity in Examination and Collection generates significant support costs (e.g., litigation, subsequent processing, etc.) and "follow-on work" (e.g., appeals resulting from tax audits) spanning a number of years. Collection and Examination estimates in this plan incorporate these support and follow-on costs.

II. Current Audit Coverage

Assuming Examination will receive 2,500 additional average positions in both FY 1988 and FY 1989 as anticipated under the current Revenue Initiative, but will receive no further staffing increases in FY 1990-92, audit coverage is estimated at:

FY 1988	FY 1989	FY 1990	FY 1991	FY 1992
1.61%	1.80%	1.86%	1.79%*	1.73%*

*Although staffing remains constant from FY 1990-1992, there is a decrease in audit coverage for FY 1991 and FY 1992 because the volume of returns filed is projected to increase.

III. Additional Resources and Expected Performance

A. Overview

The Committee asked "...how the Service would allocate additional increments of 2,500-5,000 average positions above the President's program, together with revenue return and expected performance anticipated therefrom..." As noted in

section I.C. above, the priorities of the Service are first to provide a higher level of taxpayer service, second to provide balance among functional programs, third to deal with special compliance problems, and fourth to expand Examination and Collection programs. Two scenarios of resources are summarized in section III.F. following. The only variant between the two is the number of average positions allocated to Examination and Collection. In the first scenario, the Service kept resource requirements at the low end of the 2,500-5,000 average position range. In the second scenario, the Service included the maximum possible increases for Examination and Collection while still maintaining the total staffing increase within the 2,500-5,000 average positions per year (12,500-25,000 over five years) range.

B. Taxpayer Service Program

Increases for the Taxpayer Service program under this plan are aimed at optimizing the level of service in the telephone answering function, and reducing costs while increasing efficiency through automation. Major trends affecting Taxpayer Service over the next five years include increasing suburbanization of the population, an increasing proportion of account related work (e.g. calls concerning IRS balance due notices), and an aging population requiring an increased level of assistance.

With the additional resources under this plan, the Service would:

- Increase the level of telephone service from 65 percent to 85 percent. (Note: The FY 1987 budget request provided for a 65% level of service; subsequent redirection provided for a 75% level of service.)

- Increase the capacity of the Automated Technical and Refund Inquiry System which provides computerized tax law and tax refund information. Handling more taxpayer queries by computer should decrease demand for "live" telephone service, helping to achieve the desired 85% level of service.

- Implement an Automated Taxpayer Service System to reduce costs and improve quality of assistance, providing assistor "workstations" with computerized access to all taxpayer account information and technical tax law references.

- Increase the level of assistance provided by Taxpayer Information and Education Programs, emphasizing programs for Self-Employed individuals.

The Service believes that an 85% level of telephone service is an optimal balance of service to the public and efficient use of personnel. Increasing the level of telephone service to 85 percent would require 1,123 additional positions above the President's FY 1988 budget, and the same additional staffing in each of FY 1989 through FY 1992 to maintain that level. The costs of all Taxpayer Service initiatives under this plan are summarized below:

	FY1988	FY1989	FY1990	FY1991	FY1992
Provide 85% Level of Telephone Service Average Positions	1,123	1,123	1,123	1,123	1,123
Provide additional capacity for the Automated Tech. Refund Inquiry System ($000s)	0	598	1,201	1,964	2,743
Develop and install an Automated Taxpayer Service Workstation System					
Average Positions	2	160	184	77	77
($000s)	355	4,552	6,602	3,175	3,175
Provide increased level of Taxpayer Information and Education Programs ($000s)	12,100	11,000	12,100	13,300	14,600

C. Maintaining Balance Among Service Programs

Service management shares the Committee's concern for maintaining balance among functional programs. In expanding compliance programs, planning for new procedures stemming from changes in the tax code, shifting resources to fund priority projects such as the Organized Crime Drug Enforcement Task Forces, etc., the Service must assure that base levels of service to the public (e.g., determination letters in Employee Plans, service center correspondence) and basic programs important to the continued efficient operation of the agency (e.g., the General Enforcement Program in Criminal Investigation, the Integrity Program in Internal Security, management audits by Internal Audit) are maintained. The areas below require additional resources to restore a balanced program.

1. Employee Plans

Resources to audit employee benefit plans have not kept pace with the growth in the number of plans. Three out of four plans examined have compliance problems. Additional resources are needed to conduct examinations of collectively bargained plans (as recommended by the President's Commission on Organized Crime); the marketing, investment, and distribution activities of non-bank trustee plans; and pension plans' unrelated business activities subject to income tax. An additional 84 average positions in FY 1988, plus an additional 285 in FY 1989-1992, would provide a balanced Employee Plan examination program.

	FY 1988	FY1989	FY1990	FY1991	FY1992
Employee Plans Examinations Average Positions	84	285	285	285	285
Additional EP Examinations (#)	2,800	6,700	6,700	6,700	6,700

2. Taxpayer Correspondence

An IRS executive study examined Service correspondence practices and procedures in 1982 and developed a number of recommendations to provide more timely and responsive replies to taxpayer queries. Almost all major recommendations have been implemented, except for a program to notify taxpayers of delays in processing their returns, explain the nature of taxpayer errors and other reasons for the delays, and provide the taxpayer with instructions which may help avoid such delays in the future. This program would send approximately 17.6 million notices and letters to taxpayers annually.

This program would aim at providing a desirable service to taxpayers. It would improve our processing operations by obviating additional queries from taxpayers and helping to avoid correspondence inventories in the correspondence, unpostable, and adjustment areas in IRS service centers. The additional costs of the program:

COSTS OF NOTIFYING TAXPAYERS OF PROCESSING DELAYS					
	FY88	FY89	FY90	FY91	FY92
Avg. Positions	341	341	341	341	341
Notices Issued (millions)	17.6	17.6	17.6	17.6	17.6

3. Internal Security and Internal Audit

Over the last few years, the Service has encountered significant increases in assaults and threats, as well as increased resource-intensive investigations of bribery and extortion, all of which have diverted resources from existing programs to identify and prevent internal fraud and corruption. Adding 27 average positions per year in FY 1988-1992 to the Service's Internal Security function would provide a balanced integrity program, allowing an additional 211 investigations annually which could result in 25 criminal prosecutions and 34 administrative actions. In addition, the Service would train 365 Inspectors in crisis management, victim/witness awareness and communications skills at a one-time FY 1988 cost of $378,000. This expenditure is necessary because Inspectors are increasingly coming into contact with taxpayers prone to violent behavior.

Internal audits have decreased from 83% of "auditable areas" in FY 1980 to 64% currently. Adding 25 additional average positions for Internal Audit would provide a balanced management audit program.

	FY88	FY89	FY90	FY91	FY92
Additional Internal Security Avg. Positions	27	27	27	27	27
Investigations (#)	211	211	211	211	211
Judgmental Training for Potentially Violent Situations ($000)	378	-	-	-	-
Additional Internal Audit Avg. Positions	25	25	25	25	25

4. Tax Fraud Investigations

Emphasis in the last few years on the Questionable Refund Program, the Tax Shelter Program, and Illegal Tax Protesters has resulted in reduced resources and coverage in other areas of the General Enforcement Program. Moreover, the establishment of the Organized Crime Drug Enforcement Task Forces required a shift of resources from General Enforcement to Special Enforcement. The "Special Compliance Problems" section of this plan includes 585 average positions in each of FY 1988 through FY 1992 to fund the Criminal Investigation function's efforts as part of the Tax Haven Offshore Bank Project (THOB). The additional resources below would restore a balanced General Enforcement Program.

	FY88	FY89	FY90	FY91	FY92
General Enforcement Program Average Positions	108	218	326	326	326
Additional Cases Initiated in GEP (#)	189	377	566	566	566

D. Special Compliance Problems

A continuing major objective of the Service is to identify and correct areas of noncompliance. In an effort to increase compliance with the tax laws, the Service has developed strategies which focus on several "special" compliance problems. Two "special" compliance areas are discussed under this plan: international tax administration and overseas tax havens. In addition, the Service's view on matching business information documents is given.

1. International Tax Administration

International tax issues are growing in number and complexity. The Service must expand its programs if it is to improve compliance in the international area. In FY 1989, the Service plans an increase of 50 average positions to establish an operations research function devoted to the study of international tax issues. Several other initiatives would make significant improvements in international tax administration. These initiatives, which would cost 92 positions in FY 1989, include:

- Additional staff to address money laundering overseas.

- Additional resources to pursue new strategies to identify and locate nonfilers.
- A comprehensive automated information strategy to handle increased workload.
- Increased travel resources for front-line work, program development and oversight.
- Additional resources to deal with an increase in "competent authority" issues. (Competent authority issues arise when two countries determine that each is entitled to tax the income resulting from the same business transaction.)

The following chart details the costs of these initiatives and the additional revenue they would generate.

INTERNATIONAL TAX ADMINISTRATION

	FY 1989	FY 1990	FY 1991	FY 1992
Total Avg. Positions	142	152	204	254
Travel and ADP Resources ($000's)	4,758	2,443	2,127	1,569
Additional Dollars Collected ($000's)	14,250	22,800	31,350	39,900

2. Overseas Tax Havens

Another significant special compliance issue is the use of tax haven countries to facilitate tax evasion. Recent efforts to detect and investigate fraudulent tax shelters have disclosed the use of complex transactions, involving foreign bank accounts, for the apparent purpose of tax evasion. Such investigations have historically uncovered large amounts of unreported tax liabilities, and more cases of this type are expected in the future.

A special project, the Tax Haven Offshore Bank Project (THOB), has been established to identify tax haven schemes. U.S. taxpayers suspected of using tax havens are closely scrutinized for activity in these areas against the THOB data base, which includes intelligence and filing requirement information. Intelligence experts analyze and identify tax haven activities and share their findings with field agents.

Following are estimates of the additional resources beyond current funding in the President's FY 1988 budget that would accelerate the Tax Haven Offshore Bank Project:

OVERSEAS TAX HAVENS

	FY 1988	FY 1989	FY 1990	FY 1991	FY 1992
Special Agents	450	450	450	450	450
Other Permanent	98	98	98	98	98
Related Support	37	37	37	37	37
Total Avg. Positions	585	585	585	585	585
Additional Cases Initiated in General Enforcement Program	780	780	780	780	780

3. Matching of Business Information Documents

Given the current level of interest in matching information documents that pertain to businesses, it is appropriate to comment on that subject in this report.

The Service is concerned about the correct reporting by businesses of interest and other income reported on information documents, and is constructing a computerized cross-reference file that will check business identification numbers against social security numbers. That way, information documents filed with a sole proprietorship's business identification number can be matched against the Form 1040 filed under the proprietor's social security number. Further study is needed before extending document matching to corporations, however.

Data thus far available to the Service indicates high compliance in reporting the type of income included on information documents among corporations with less than $10 million in assets and more than $100 million in assets; less is known about this type of compliance among corporations with assets between $10 million and $100 million. The Service is going to further study corporate returns to better determine the level of compliance in reporting this type of income. The results of the studies will help the

Service to determine whether it would be cost-beneficial to extend document filing and matching to corporations.

E. Examination and Collection

The committee asked the IRS how it would spend additional average positions to secure additional revenue, increase audit coverage, and reduce the tax gap. Program increases for the major compliance and revenue producing areas...Examination and Collection, are the most effective way of pursuing these objectives. Two scenarios were developed for Examination and Collection staffing. The first keeps total Service staffing increases under this plan at the low end of the 2,500-5,000 average position per year (12,500-25,000 over five years) range suggested by the Committee. The second includes the maximum possible increases for these programs while still keeping within the suggested range. Staffing for the Collection function would be used to reduce the existing accounts receivable inventory, to pursue nonfilers through the Delinquent Returns program, and to handle new accounts receivable work generated by new initiatives in Examination and Delinquent Returns.

In planning additional average positions for the major revenue producing functions, the Service is limited by the ability of the functions to recruit, train, and deploy new staff. In the present FY 1988 budget, 2,500 additional average positions are already planned for Examination, 2,970 for Collection (Accounts Receivable), and 1,360 average positions for IRP. In addition, under a revenue initiative, Examination is scheduled to receive 2,500 additional average positions in FY 1989. The table below reflects the maximum possible assimilation levels used in developing the scenarios.

MAXIMUM ASSIMILATION LEVELS
INCREMENTAL AVERAGE POSITIONS

	FY88	FY89	FY90	FY91	FY92
Collection	0	2,500	2,500	2,500	2,500
Examination	0	0	2,500	2,500	2,500

A model was used to calculate the support and follow-on average positions for such areas as Information Systems, Appeals, Accounts Receivable, etc., generated over the next five years from adding staff in a particular year, as well as the revenue stream emanating from the additional average positions. Attachment 3 contains charts detailing the two scenarios:

Highlights:

Scenario One...Lower Range

- By FY 1992, Examination staffing will be up by 3,500 average positions, Collection by 5,110 (2,320 in delinquent returns, 2,790 in accounts receivable), and follow-on and support areas by 847 for a total average position increase of 9,457 over the FY 1988 base.

- Revenue streams generated from the additional staff years will total $6.3 billion, with $5.4 billion collected through FY 1992, and the remainder collected after FY 1992.

- Audit "coverage" will increase from 1.61% in FY 1988 to 2.01% in FY 1992, as compared to 1.73% under current budget plans.

Scenario Two...Higher Range

- By FY 1992, Examination staffing will be up by 7,500, Collection by 10,000 (6,108 in delinquent returns, 3,892 in accounts receivable), and follow-on and support functions by 1,791, a total of 19,291 average positions over FY 1988 levels.

- Revenue generated from the additional staffing will total $11.6 billion, with $9.4 billion collected through FY 1992, and the remainder collected after FY 1992.

- Audit "coverage" will increase from 1.61% in FY 1988 to 2.06% in FY 1992, as compared to 1.73% under current budget plans.

The Service believes that increased compliance programs will generate improvements in voluntary compliance and reductions in the tax gap for future years. However, it is not possible to quantify in specific terms the improvements which will likely occur under the above scenarios.

F. Summary Tables

1. Additional Average Positions...Lower Range Scenario
2. Additional Average Positions...Higher Range Scenario
3. Additional Non-Staff Resources
4. Additional Dollars Collected...Both Scenarios

Summary Table One
Scenario One...Lower Range
(Additional Average Positions)

	FY88	FY89	FY90	FY91	FY92
Taxpayer Service*	1,125	1,283	1,307	1,200	1,200
Maintaining and Improving Balance*					
Employee Plans	84	285	285	285	285
Taxpayer Correspondence	341	341	341	341	341
Internal Security	27	27	27	27	27
Internal Audit	25	25	25	25	25
Tax Fraud Invest.	108	218	326	326	326
Special Compliance Problems*					
International Tax Administration	-	142	152	204	254
Overseas Tax Havens	585	585	585	585	585
Collection	-	1,956	2,695	3,967	5,110
Examination	-	-	1,500	2,500	3,500
Collection /Examination Follow-on & Support		138	257	540	847
TOTAL	2,295	5,000	7,500	10,000	12,500

* Average positions for these areas are identical in both scenarios.

Summary Table Two
Scenario Two...Higher Range
(Additional Average Positions)

	FY88	FY89	FY90	FY91	FY92
Taxpayer Service*	1,125	1,283	1,307	1,200	1,200
Maintaining and Improving Balance*					
Employee Plans	84	285	285	285	285
Taxpayer Correspondence	341	341	341	341	341
Internal Security	27	27	27	27	27
Internal Audit	25	25	25	25	25
Tax Fraud Invest.	108	218	326	326	326
Special Compliance Problems*					
International Tax Administration	-	142	152	204	254
Overseas Tax Havens	585	585	585	585	585
Collection	-	2,500	5,000	7,500	10,000
Examination	-	-	2,500	5,000	7,500
Collection/Examination Follow-on & Support		179	525	1,095	1,791
TOTAL	2,295	5,585	11,073	16,588	22,334

* Average positions for these areas are identical in both scenarios.

Summary Table Three
Additional Non-Staff Resources - $000

	FY88	FY89	FY90	FY91	FY92
Taxpayer Service					
Additional Capacity for Automated Tech. Refund Inquiry Sys.	0	598	1,201	1,964	2,743
Develop and Install Automated Taxpayer Service System	355	4,552	6,602	3,175	3,175
Provide increased level of Taxpayer Information and Education Progs.	12,100	11,000	12,100	13,300	14,600
Internal Security					
Judgmental Training for Potentially Violent Situations	378	-	-	-	-
International Tax Administration					
Travel	-	500	750	850	950
Information Systems	-	4,258	1,693	1,277	619
TOTAL	12,833	20,908	22,346	20,566	22,087

Summary Table Four
(Additional Dollars Collected - $ millions)

Scenario One

	FY88	FY89	FY90	FY91	FY92	FY93-96
Collection	-	424.7	730.4	1,049.1	1,367.2	504.1
Examination	-	-	255.5	613.3	947.0	423.4
International Tax Administration	-	14.3	22.8	31.4	39.9	n/a
TOTAL	-	439.0	1,008.7	1,693.8	2,354.1	927.5

TOTAL FY88 - FY92: 5,495.6
TOTAL FY88 - FY96: 6,423.1

Scenario Two

	FY88	FY89	FY90	FY91	FY92	FY93-96
Collection	-	518.4	1,109.4	1,643.2	2,252.3	1,258.1
Examination	-	-	430.2	1,250.1	2,169.9	936.7
International Tax Administration	-	14.3	22.8	31.4	39.9	n/a
TOTAL	-	532.7	1,562.4	2,924.7	4,462.1	2,194.8

TOTAL FY88 - FY92: 9,481.9
TOTAL FY88 - FY96: 11,676.7

n/a Estimates of revenue streams for the International Tax Administration area are not available for FY93-96.

IV. Costs of Implementing the Tax Reform Act of 1986

The Tax Reform Act of 1986 is the most comprehensive change to the tax administration system since 1954. With eighteen titles containing over 300 new or significantly changed tax code provisions, the Act will have a dramatic impact on IRS operations. To implement the provisions in the Tax Reform Act, the Service is requesting an FY 1987 budget supplemental of 932 positions and $80 million. (The cost of implementing tax reform legislation was not included in the FY 1987 Continuing Resolution.) The Service estimates that additional resources of 1,964 positions and $80 million will be required in FY 1988 (over the FY 1987 budget request before the supplement request). These resources will be used to:

- Educate taxpayers so that they understand and, hence, can fully comply with the new tax code, an effort that will require a large-scale mailing to employers of the revised W-4 (withholding form), other new forms and schedules, and new and modified reporting requirements;

- Respond to a significant increase in taxpayer requests for assistance in understanding the new law and filling out new forms, particularly the revised W-4 form every taxpayer is required to file by October 1, 1987;

- Train the technical workforce to apply new tax code provisions, accurately answer taxpayer questions, and revise rules and regulations; and

- Fulfill other program requirements, including transcribing large quantities of data from new and revised forms to computer tape, revising major segments of existing computer code, reviewing employee benefits plans, and revising and writing a myriad of rules and regulations.

The following chart summarizes the Service's costs in FY 1987 and FY 1988 to implement tax reform:

INTERNAL REVENUE SERVICE
SUMMARY OF RESOURCES FOR TAX REFORM
(Dollars in Thousands)

	FY 1987		FY 1988	
	AVG. FOS.	$	AVG. FOS.	$
Returns Processing and revenue accounting.....	377	$49,766	1,050	$38,122
Computer Services.....	86	$5,434	128	$8,870
Subtotal.....	463	$55,200	1,178	$46,992
Examination.....	0	$1,895	0	$2,451
Appeals and tax litigation..	3	$779	3	$771
Employee plans and exempt organizations.....	111	$3,908	292	$10,319
International.....	31	$1,528	51	$2,273
Subtotal.....	145	$8,110	346	$15,814
Tax fraud investigations...	0	$0	0	$430
Collection.....	0	$1,862	0	$231
Taxpayer service.....	301	$13,442	411	$15,121
Enforcement litigation and technical.....	23	$1,386	29	$1,412
Subtotal.....	324	$16,690	440	$17,194
GRAND TOTAL.....	932	$80,000	1964	$80,000

Committee Request

IRS FIVE-YEAR PLAN

The Committee believes that, in order to properly allocate resources, the Service should prepare a five-year plan aimed at reducing the tax gap, increasing the level of voluntary compliance among taxpayers, dealing with special compliance problems such as abusive tax shelters and overseas tax havens, ensuring an effective level of taxpayer services, and maintaining balance among functional programs to prevent emergence of backlogs such as those now existing in Appeals, regulations, and taxpayer delinquent investigations. The first five-year plan should be submitted to the Committee on Appropriations of the House and Senate not later than October 1, 1986 and should cover the period FY 1987 through FY 1991. Thereafter, the plan should be updated annually and submitted with the budget justification for each fiscal year. The plan should contain, as a minimum, the following information for each fiscal year included:

a. A forecast of the legal-source income tax gap, voluntary compliance percentage, and audit coverage under current policies and programs reflected in the President's budget;

b. How the Service would allocate additional increments of 2,500 to 5,000 average positions above the President's program, together with the revenue return and/or performance anticipated therefrom, and a projection of the tax gap, audit coverage and voluntary compliance percentage under each scenario of additional resources;

c. A statement of resource requirements and their allocation aimed at raising the level of voluntary compliance toward an ultimate objective (which does not have to be within the five-year time span) of 90 percent, together with the revenue return or performance, and projection of tax gap, compliance percentage, and audit coverage for this scenario of resources;

d. A statement of resource requirements and their allocation to deal with special compliance problems, such as tax shelters and overseas tax havens, and the revenue return or performance anticipated therefrom,

e. A statement of resource requirements and their allocation to deal with additional workload created by tax law changes or new missions enacted by Congress, together with revenue return or performance anticipated therefrom.

Attachment 1

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

SEP 22 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

In your letter of June 16, you requested information on the revenue yield that would result from funding the Internal Revenue Service at levels consistent with our ability to assimilate additional resources over the next five years. I must apologize for the long delay in responding to your request.

Enclosed is our analysis of assimilation levels for 1987 and each succeeding year through 1991 and the corresponding revenue which would result. As you can see, if the IRS were funded at a level consistent with our ability to hire, train and deploy additional staff, we estimate that these resources would generate additional net revenues of $33 billion over the five year period.

I have not included a comparison of these assimilation levels against the proposed trust fund. As you know, House and Senate conferees have agreed to delete this provision from tax reform legislation.

Again, I regret the delay in responding to you. I appreciate the support and concern that your Subcommittee has shown to ensure adequate funding for IRS to effectively administer the nation's tax laws. I hope this information is useful to you and I particularly look forward to a close working relationship with you and your Subcommittee.

With best regards,

Sincerely,

Larry Gibbs

Enclosure

Department of the Treasury Internal Revenue Service

Attachment 2

Attachment 2 (cont.)

EXAMINATION AND COLLECTION...Scenario One

	FY88	FY89	FY90	FY91	FY92	FY93-96
AVERAGE POSITIONS AVAILABLE (CUM)	2,500	5,000	7,500	10,000	12,500	
AVERAGE POSITIONS USED (CUM)						
Collection						
Delinquent Returns		1,202	1,273	1,860	2,320	
Accounts Receivable (Exam and D/R)*		254	422	607	790	
Accounts Receivable (Inventory)**		500	1,000	1,500	2,000	
Total		1,956	2,695	3,967	5,110	
Examination			1,500	2,500	3,500	
Other Support and Follow-on		138	257	540	847	
TOTAL USED		2,094	4,452	7,007	9,457	

ADDITIONAL DOLLARS COLLECTED $000 (PER YEAR)

						TOTAL
From Examinations		255,474	613,356	946,973	423,362	2,239,165
From Delinquent Returns	207,466	315,521	456,292	615,918	504,137	2,099,334
From Accounts Receivable (Inventory)	217,191	414,914	592,852	751,291	***	1,976,248
TOTAL	424,657	985,909	1,662,500	2,314,182	927,499	6,314,747

AUDIT "COVERAGE" (%)	1.61	1.8	2.00	2.04	2.01	

* Generated by new initiatives in Examination and Deliquent Returns.

** Devoted to reducing existing accounts receivable inventory.

*** Dollars collected by staffing devoted to reducing the existing accounts receivable inventory are all shown in the year of investment.

Attachment 3 (a)

EXAMINATION AND COLLECTION...Scenario Two

	FY88	FY89	FY90	FY91	FY92	FY93-96
AVERAGE POSITIONS AVAILABLE (CUM)	5,000	10,000	15,000	20,000	25,000	
AVERAGE POSITIONS USED (CUM)						
Collection						
Delinquent Returns		1,651	3,150	4,633	6,108	
Accounts Receivable (Exam and D/R)*		349	850	1,367	1,892	
Accounts Receivable (Inventory)**		500	1,000	1,500	2,000	
Total		2,500	5,000	7,500	10,000	
Examination			2,500	5,000	7,500	
Other Support and Follow-on		179	525	1,095	1,791	
IRS TOTAL	0	2,679	8,025	13,595	19,291	

ADDITIONAL DOLLARS COLLECTED $000 (PER YEAR)

						TOTAL
From Examination		430,190	1,250,100	2,169,880	936,690	4,786,860
From Delinquent Returns	301,748	694,510	1,050,382	1,500,793	1,258,122	4,805,055
From Accounts Receivable (Inventory)	217,191	414,914	592,852	751,291	***	1,976,248
TOTAL	518,439	1,539,614	2,893,334	4,421,964	2,194,812	11,568,163

AUDIT "COVERAGE" (%)	1.61	1.8	2.01	2.06	2.06	

* Generated by new initiatives in Examination and Deliquent Returns.

** Devoted to reducing existing accounts receivable inventory.

*** Dollars collected by staffing devoted to reducing the existing accounts receivable inventory are all shown in the year of investment.

Attachment 3 (b)

Addendum

INTERNAL REVENUE SERVICE FIVE YEAR RESOURCE PLAN
Scenario One...Lower Range
(Additional Cost - Dollars in Thousands)

	FY 88	FY 89	FY 90	FY 91	FY 92
Taxpayer Service	$48,146	$46,707	$47,413	$45,500	$44,747
Maintaining and Improving Balance					
Employee Plans	3,149	10,452	9,742	9,999	10,047
Taxpayer Correspondence	9,725	8,521	8,571	8,617	8,653
Internal Security	1,489	1,123	1,134	1,143	1,152
Internal Audit	1,150	953	961	971	977
Tax Fraud Invest.	6,062	10,820	15,751	14,505	14,957
Special Compliance Problems					
International Tax Administration	---	7,005	6,725	10,308	13,063
Overseas Tax Havens	32,768	24,231	25,926	26,630	26,793
Collection	---	84,675	109,963	170,246	219,404
Examination	---	---	66,959	105,647	151,978
Collection/Examination Follow-on & Support	---	6,846	12,980	27,545	43,637
TOTAL	$102,489	$201,333	$306,125	$421,111	$535,408
Related Support Staffing Cost	7,561	14,500	20,314	26,134	34,616
TOTAL STAFFING COST	$110,050	$215,833	$326,439	$447,245	$570,024
Additional Non-Staff Resources	24,747	33,239	35,047	33,610	35,391
TOTAL COST	$134,797	$249,072	$361,486	$480,855	$605,415

Addendum

INTERNAL REVENUE SERVICE FIVE YEAR RESOURCE PLAN
Scenario Two...Higher Range
(Additional Cost - Dollars in Thousands)

	FY 88	FY 89	FY 90	FY 91	FY 92
Taxpayer Service	$48,146	$46,707	$47,413	$45,500	$44,747
Maintaining and Improving Balance					
Employee Plans	3,149	10,452	9,742	9,999	10,047
Taxpayer Correspondence	9,725	8,521	8,571	8,617	8,653
Internal Security	1,489	1,123	1,134	1,143	1,152
Internal Audit	1,150	953	961	971	977
Tax Fraud Invest.	6,062	10,820	15,751	14,505	14,957
Special Compliance Problems					
International Tax Administration	---	7,005	6,725	10,308	13,063
Overseas Tax Havens	32,768	24,231	25,926	26,630	26,793
Collection *	---	108,225	208,904	318,867	429,812
Examination *	---	---	111,593	213,714	325,062
Collection/Examination Follow-on & Support	---	9,498	24,104	55,303	91,357
TOTAL	$102,489	$227,535	$460,824	$705,557	$966,620
Related Support Staffing Cost	7,561	16,397	30,965	43,808	57,053
TOTAL STAFFING COST	$110,050	$243,932	$491,789	$749,365	$1,023,673
Additional Non-Staff Resources	24,747	33,239	35,047	33,610	35,391
TOTAL COST	$134,797	$277,171	$526,836	$782,975	$1,059,064

* Examination and Collection costs have been increased to reflect the Federal Employee Retirement System.